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THE CHAMBER'S JOURNAL

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YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

A Monthly Journal of
The Chamber of Tax Consultants

Concepts Relevant to Taxation Law & Practice

Part II

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It aims to provide clarity on fundamentals of foreign exchange laws under Foreign Exchange Management Act, 1999 ("FEMA") and allied laws. It covers complex concepts in a concise manner and covers all the important areas under FEMA operations.

Sudhir Kochhar; INR 1,895/-; *1022 pages* i

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The Chamber's Journal

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Editorial

With a heavy heart, we all pay homage to the bravehearts of Central Reserve Police Force who were martyred in the line of duty on February 14, 2019 when the convoy of vehicles carrying security personnel on the Jammu Srinagar National Highway was attacked. The gruesome act of terrorism has again brought to the fore whether our policy of restrained response to such deadly attacks is justified. Unfortunately, our neighbouring country, Pakistan is engaging us in a strategic war by bleeding the enemy with a thousand cuts. Immediately after the attack, the entire country wanted a befitting response to the same. Our country has responded by taking severe and targeted action against terrorism by carrying out aerial strikes on February 26, 2019. This action has sent a message to the world and to ourselves that being defensive is considered as weakness. Aggression is a preventive step to keep nuisance at bay. Hence, such an action was imperative. I am reminded of a statement of the then Secretary of State, USA, Ms. Hillary Clinton given during a joint news conference with Pakistani Foreign Minister Hina Rabbani Khan on October 21, 2011. I quote "it's like that old story – you can't keep snakes at your backyard and expect them only to bite your neighbours. Eventually, those snakes are going to turn on whoever has them in the backyard." She was correct in the first part of her statement, however, the last part of her statement was not factually correct. Pakistan administration knows for sure that these snakes are trained in such a manner that they are going to harm the neighbours only. Thus, we as a civilised nation do not have any other option than to seek out these snakes and eliminate them. We should always remember that we have to keep the heat on and be vigilant to avoid any future snakes in the neighbour's backyard. Eventually, common man in our neighbourhood will also realise that we are doing a favour to them also.

While I was penning this editorial, the Election Commission of India has announced the schedule for conducting elections for the 17th Lok Sabha. Now, the entire country officially gets into election mode till the results are declared on 23rd May, 2019. Democracy is a double-edged sword. If we do not exercise the right to vote sincerely and diligently, it will harm us. So, I request all to exercise their right without fail.

Special story for this month of March 2019 is a **Part II** of **Concepts Relevant to Taxation Law and Practice**. Eminent authors have given their views on the complicated issue dealt by them. I thank all the contributors to this issue for sparing their valuable time.

K. GOPAL
Editor

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From the President

"iyi bir öğretmen bir mum gibidir ... başkalarının yolunu aydınlatmak için kendini tüketir"

is a **Turkish quote** which says – ***a good teacher is like a candle...it consumes itself to light the way for others!***

And it is exactly this, what we at the Chamber, believe in! The roots of the Chamber and its embedded ideals focus on benefitting the society at large by sacrificing individual interest, imparting limitless learning, spreading knowledge far and wide, and being a benevolent teacher. The Chamber has evolved as an institution which has shaped itself into a teacher; a body which personifies endless growth through learning and experience and a pillar which strengthens our confidence by keeping us regularly updated. And this makes me say – the Chamber, a temple of knowledge, is empowered by its members and their contributions as much as by its ideals and principles.

In Swami Vivekananda's words – *"Arise! Awake! And stop not till thy goal is reached!"* And probably, we'll never stop because after accomplishing one goal, we always envision the next one! And in the interim, we should constantly keep the learning curve moving up. In APJ Abdul Kalam's words – *"If four things are followed – having a great aim, acquiring knowledge, hard work, and perseverance – then anything can be achieved!"*

The month that has passed has seen many interesting events, the saddest one being the cruel attacks on CRPF convoys by terrorist groups. I would like to extend my heart-felt condolences for the jawans martyred in the Pulwama attacks and would like to urge the stakeholders and the members to extend help in whatever way possible to the ones who laid down their lives, protecting us.

The month of March also houses two major festivals – Maha Shivratri and Holi. It is believed that the people who fast on this night and offer prayers to Lord Shiva bring good luck into their life. Holi is one of the most colourful festivals celebrated in India with full zeal and enthusiasm. Holi is celebrated as an icon of destruction of the evil and on this auspicious occasion I wish all my friends, members and stakeholders a happy and a safe Holi.

This month also saw the conclusion of one the most grand Maha-Melas of the world – the Kumbh Mela. This biggest religious gathering organised at the banks of confluence of three holy rivers Ganga, Yamuna and mythical Saraswati, has created three world records this year - for largest traffic and crowd management plan of 24 crore visitors in 49 days; the biggest painting exercise at public places under the 'paint my city' scheme; and the third world record is a testimony to Prime Minister Narendra Modi's Clean India Mission for the world's biggest sanitation and waste disposal mechanism and instal about 150,000 mobile toilets.

A *man asked a Sculpturist "How do you make such beautiful Idols from Stone?. He replied: "Idols and Images are already hidden there….I only removed the unwanted stones".* ***Moral: Your happiness is hidden within you, just remove the worries and enjoy your life.***

CTC News

CTC's flagship – ***The Dastur Essay Competition*** this year has seen the highest number of registrations in the history of CTC with about 467 registrations flowing in till 15th February, 2019.

This month also saw CTC organising a successful and splendid ***42nd Residential Refresher Course (RRC) at Lucknow*** inaugurated by the Honourable Uttar Pradesh Governor – Shri Ram Naik ji, with record 223 delegates, inscribing it in CTC's history as one of the largest attended RRC's ever conducted with the highest ever recorded delegates in the last 42 years.

Announcing the ***13th Residential Conference on International Taxation*** with a galaxy of speakers, which will be held on Thursday, 20th June to Sunday, 23rd June, 2019 at Surat. The RRC has already seen 140 registrations under early-bird offer, that is till 28th February, 2019. I am hopeful of seeing this RRC again breaking all previous records of attendance and turn out as successful and enjoyable as the one at Lucknow.

The 12th of this month will also see a Lecture Meeting on ***"Current Economic Scenario and Ease of Doing Business in India"*** jointly with Indo-Japanese Association and Institute of Company Secretaries of India.

The CTC in association with Government Law College this month announces the ***3rd Edition of the Dr. Y. P. Trivedi National Tax Moot Court Competition.*** This year, the Moot Proposition will be based on Benami Transactions (Prohibition) Act, 1988 and Income-tax Act and is scheduled to be held on the 29th and 30th March.

The 8th day of March will see a Lecture meeting on ***"Life is Beautiful"*** by Swami Gyanvatsaldas ji, which will aim at balancing our lives and taking stock of our own balance sheet not only in terms of financial assets and liabilities but also our families and friends, our social interactions, our own mind and most importantly our spiritual self.

We have also planned unique ***Student Orientation Programme*** with new design from 13th to 15th March, 2019 at Mulund, Mumbai.

In current mobile and digital scenario, we are slaves of gadgets and equipment and forgotten art of memory. We have organised lecture meeting on ***"Dynamic Memory"*** on 11th March, 2019.

Triangular Cricket match is being held on 17th March between CTC, GSTPAM and MCTC to foster friendship and greater bonding of members.

Announcing the ***Industrial visit*** on 6th and 7th March to Volkswagen Plant & Parag Milk Foods Ltd., to acquaint students and members with various functions, activities and procedures related to management of industrial plants. We have batches of 40 students and members on both days.

Special Story for March, 2019 is continuation and Part 2 of "Concepts Relevant to Taxation, Law and Practice". I once again thank K. Gopal and Ajay Singh.

It brings me immense pleasure to announce new events and activities CTC initiates every month and it is this which keeps the wheel going and signifies progress by adding new laurels to this great institution with many more to come.

Let's come together and unite ourselves in this mission of growing CTC and making it reach newer heights. Ultimately, in Sardar Vallabhbhai Patel's words – *"Manpower without unity is not a strength unless it is harmonised and united properly, then it becomes a spiritual power!"*

Thanking you.

Hinesh R. Doshi
President

Rajendra, *Advocate*

Allowable Business Expenditure

As per the Indian traditions '*Artha*' (Wealth), is the second *Purusārtha* (goal of humankind) that a person should attain during his lifetime. Various economic activities, including agriculture, business and profession were treated as the foundation stones of *Arth* by Ved Vyas in Mahabharat and Kautiliya in Arthashastra. For centuries together Land Revenue used to be main source of income for State all over the globe. But, the historical Napoleonic Wars brought a new item of taxation i.e. Income tax. Though, it was introduced in the United Kingdom in the year 1799, for the first time, to 'pay for weapons and equipment in preparation for the war'. Yet, this 'unwanted guest', as termed in a lighter vein, slowly and steadily became the 'permanent' member of the national tax system of United Kingdom. If it was war with Napoleon that brought the 'misery' of Income-tax in UK, for Indians, the Revolution of 1857 brought a 'burden' of a new legislation (Act XXXII of 1860) that provided for levying of 'Duty'on various sources of income in India for the first time. It ushered a new era of collection of income-tax as well as of tax-litigation. Interestingly, most of the taxation concepts and the principles, governing the modern tax legislations, can easily be traced in the earlier tax statutes (Acts of 1860, 1866, 1869, 1870 and1886) and the early case laws dealing with income-tax. The purpose of all the income-tax enactments was and is to determine the share of the Sovereign in the income of an assessee.

Word, *income*, In the most simple form, as taught at the National Academy of Direct Taxes, Nagpur, means *coming in* of something in the pocket. Similarly, expenditure can be defined as going out of something from the pocket of the assessee. But the term expenditure cannot be explained in such a simple manner. The Hon'ble Supreme Court, in the judgment of *Indian Molasses Co. (P.) Ltd. (37 ITR 66)* has held that the word *expenditure* means *put out or away; spending something which is gone out irretrievably*. As per the *Eastern Spinning Mills Ltd. (126 ITR 686)* expenditure in a sense was equal to disbursement which, to use a homely phrase, meant something which went out of a trader's pocket. In the matter of *B. K. Khanna and Co. (P.) Ltd. (247 ITR 705)* the Hon'ble Delhi High Court has stated that *spending* in the sense of *paying out or away* of money is the primary meaning of 'expenditure'. The Kerala High Court in the case of *St. George Forana Church (170 ITR 62)* has defined the term expenditure and has held that the word *expenditure* means disbursement

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and that *Expend* means *to pay out or distribute; to spend*. It can be held, after considering the above, that a business expenditure is a voluntary Act on the part of a businessman to spend or set apart money for carrying on, or in connection with, his business with a view to earning profits.

One of the crucial and important steps, for determining the taxable income of the assessee, is to determine allowable expenditure, because, as per the tax statutes, legitimate expenses related an economic activity have to be allowed. For arriving at the figure of profits and gains of business /profession for the purpose of section 28 of the Income-tax Act, 1961 (Act), what is to be considered is the net profits/gains in the commercial sense and not only receipts. Besides, all amounts which are proper items of expenditure has to be deducted at the stage of arriving at the figure of profits/gains of business (103 ITR 298). Major principle regarding some of the allowable expenses (sections 30, 31, 36 and 37) will be discussed in following paragraphs.

Allowability of expenses can easily be termed a proverbial bone of contention between the tax collectors and taxpayers. If the matters, decided by the courts till date and the matters pending at various judicial forums as on today are analysed, one fact emerges prominently – the claims of expenses/deductions/rebates/ exemptions constituted and still constitute the major portion tax-litigation. Expenditure incurred by the assessees have been dealt by the courts from time-to-time. In order to qualify for deduction under the Act, the expenses incurred should have a direct bearing and nexus with the economic activities carried out by the businessman/professional or the expenses should have been incurred to facilitate carrying on of the business of the assessee.

In the case of *Rayalu Ayyar & Co. (5 ITR 727-Mad., 1938)*, it was held that an expenditure made 'to earn profits' could be allowed while computing the taxable income of an assessee. It has been held that the expression 'for the purpose of the business' is wider in scope than the expression 'for the purpose of earning profits', that however, wide the meaning of the expression may be, its limits are implicit in it, that it should be for the purpose of the business, that is to say, the expenditure incurred should be for the carrying on of the business and the assessee should incur it in his capacity as a person carrying on the business (148 ITR 418-All.). In short, spending or outgoing sought to be deducted should bear a character which has a connection with or relation to the particular activity which produces the income or constitutes its source. In the case of *Badrinarayan Shrinarayan Akodiya* the Hon'ble MP High Court (101 ITR 817) has held as under:

> *"The phrase 'for the purposes of the business' in section 37(1) of the Income-tax Act, 1961, has a particular meaning, namely, either the expenditure must be necessary for the purposes of the business or it may have to be incurred on account of the practice prevailing in any particular trade or business."*

In a case, when it was found that the expenditure incurred in payment of managerial remuneration to the directors of the subsidiary companies could not be said to be expenditure incurred in carrying on the business of the assessee-company of holding its investments, the Hon'ble Apex Court held that the assessee-company could hold its investments and earn its dividends without incurring this expenditure, that the subsidiary companies were not obliged to distribute by way of dividends the entire profits earned on account of their managerial remuneration paid by the assessee-company, that the assessee-company was only entitled to dividend from the subsidiary company as and when declared, that it could not be said that there was a direct and immediate connection between the expenditure incurred and the business of the assessee-company (226 ITR 188). In the matter of *Birla Cotton Spinning & Weaving Mills Ltd. (82 ITR 166)*, it was found that there was direct connection between the expenses and the character of the assessee as a trader, hence same was allowed. In *Sree Meenakshi Mills Ltd. (63 ITR 207),* it was laid down by the Hon'ble Supreme Court that for allowing an expenditure it is not necessary that the primary motive in incurring the expenses must be directly to earn income thereby. In other words, direct connection with the business and not direct connection with earning of income is the basis for allowability of an expenditure. In the matter of *Globe Theatres Pvt. Ltd. (122 ITR 240),* the Hon'ble Bombay High Court observed that in order to decide whether a particular amount is laid out or expended wholly or exclusively for the purposes of the assessee's business, the test to be applied is: Has the expense been incurred with the sole object of *furthering* the trade or business 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. For arriving at the conclusion that the expenditure was dictated solely by business consideration – the nature of the business, the way it is conducted and any likelihood of the business being adversely affected – has to be considered. In the case of *Ambala Bus Syndicate Private Ltd. (95 ITR 383),* when the Hon'ble P & H Court found that the assessee had contributed to a fund to prevent nationalisation of bus route permit and finally was successful in getting an extension of seven years for its route permits. The Hon'ble Court observed that there was a clear connection between the expenses incurred by the assessee and the business conducted by it, so same has to be allowed.

Because of the necessity of close relationship between the two, the revenue authorities and the taxpayers make totally opposite claims about expenses incurred. The remotest possible connection with the business/profession is claimed as the most immediate, intricate, interlaced relation by the assessee e.g., expenses incurred for bye pass surgery of heart was claimed as allowable expenditure. On the other hand, the AO.s reject even those claims where the expenditure and the commercial activities have most direct connection with the business. These two extreme views can be termed as origin (*Udgam*) of the *Gangotri* of litigation.

Secondly, it is the assessee who has to lead the evidence that expenditure was incurred by him for earning the income under a particular head. Though, making payment or spending something is the basic ingredient of term expenditure. But, all such payments, made for earning income under head business income, are not always allowable. Besides incurring expenses the assessee has to fulfil some other preconditions, as required by a particular section dealing with such expenditure. In the matter of *Saraswati Industrial Syndicate Ltd. (84 ITR 544-P&H)* it was held that in order to claim a deduction on account of expenditure for purposes of business, the onus lies on the assessee to prove that the expenditure was incurred for the purpose of business. The Hon'ble Bombay High Court in the case of *Ramanand Sagar (256 ITR 134)* has held as follows:

> *"Section 37 of the Income-tax Act, 1961, deals with the question relating to the allowability of the expenditure incurred for the purposes of business. The onus of proof is upon the assessee to prove each of the following ingredients before the expenditure can be allowed as deduction……. If the assessee fails to satisfy any of these tests, the expenditure claimed is not allowable."*

Some of the principles regarding the expenses, evolved over the period of time, can be enumerated as under

i. Unless an expenditure can be brought under sections 30 to 37 of the Act, it cannot be allowed as a deduction in computing the business profits.

ii. For the purpose of computing the yearly profits and gains for assessment to income-tax, each year is a separate and self-contained period of time and losses and expenses incurred before its commencement or after its expiry cannot be the subject of any allowance in assessing the income of that particular year. In making the assessment for any particular year, deductions can, therefore, be permitted only in respect of expenses which are found to have been incurred in the relevant accounting period, and the mere setting apart of an amount to meet a liability, not actually present but only contingent, cannot bear the character of expenditure till the liability becomes real.

iii. A businessman has to keep money either when he gets it as sale proceeds of the stock-in-trade or for disbursement to meet the business expenses or for purchasing stock-in-trade and if he loses such money in the ordinary course of business, the loss is a deductible trading loss. It is immaterial whether the money is a part of the stock-in-trade, such as, of a banking company or a money-lender, or is directly connected with other business operations. The risk is inherent in the carrying on of the business and is either directly connected with it or incidental to it. *(111 ITR 263-SC)*.

iv. In the case of business expenditure it matters little whether the expenditure has been incurred on the basis of a valid or invalid document. The only point to be considered is whether the expenditure was incurred in the assessment year. If it was an expenditure actually made for the purpose of the business and if it attracts the provisions of legitimate deduction permissible u/ss. 30 to 37 of the Act, the assessee will be entitled to deduction. In the absence of fraud, the question whether a transaction had the effect of reducing the assessee's taxable income or whether it was prudent or judicious or whether it was indispensable or necessary for the assessee to enter into the transaction, are all irrelevant in determining whether the expenditure relating to that transaction should be allowed u/s. 37.

v. Non-registration of a compulsorily registrable document relating to immovable property renders the document inadmissible as evidence of a transaction affecting immovable property. But it may be admitted and made use of as evidence of collateral facts or for any collateral purpose, that is, for any purpose other than that of creating, declaring, assigning, limiting or extinguishing a right to immovable property. It is admissible to prove a lessee's possession as well as to show that he was a tenant in occupation of the land on payment of rent.

Allowable Business Expenses

If the fifteen sub-sections of section 10(2) of the 1922 Act, as stood in the year 1960, are compared with the original ix sub-sections of the 1922 Act and the sub-sections 30 to 37 of the Act, it becomes clear that expenses allowable for carrying out business/ Trade/ Profession/ Vocation are more or less same and that with the passage of time the essence has remained the same, though there have been some changes here and there. Payments towards rent repair/ current repairs, capital borrowed, insurance, wear and tear of assets i. e., depreciation, local or municipal taxes, bonus/ commission paid and bad/doubtful debts are some of the items that continue to be allowable expenditure with some riders. It is true that with the ticking of time-watch, some changes have taken place in the above list or some new principle, a few of them are quite radical, have evolved. But, it is the outcome of the new ground-realities of business-world that are changing rapidly. E-commerce is shaking the foundations of traditional business in a big way. Cross-border transactions have brought new challenges for the tax administrators of all countries. New challenges are bringing new solutions and thus law is evolving.

Rent, rates, taxes, repairs and insurance for Building: Section 30

Section 30 deals with allowable expenses incurred under the heads rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession of an assessee. Almost similar kind of expenses were allowable under the 1922 Act also. But under both the Acts *factum* of building being used for the business or expenses incurred under various heads during the year under consideration has to be proved by the assessee.

In the case of *Noshirwan and Co. Pvt. Ltd. (77 ITR 822),* the Hon'ble MP High Court disallowed the claim made by the assessee u/s. 30 of the Act, as it was found that rent was not paid for the year under appeal. It was also held that the expenditure incurred in payment of rent was not allowable u/s. 37, as the section 37 was not applicable to any expenditure of the nature described in sections 30 to 36. The Hon'ble Delhi High Court *(252 ITR 622)* has in the case of *Bihar Steel Tubes Ltd.* has held that rent is allowable as deduction under section 30 of the Act, that what is allowable is the rent paid or payable for the period during which the premises are used for the purposes of business.

One of the items to be allowed u/s. 30 of the Act is expenditure incurred on current repairs. But the courts are of the view that the word repairs is not to be read in isolation, since the precise term used in the section is current repairs. Prefix i. e., current to the word repairs has to be considered carefully while applying the section. It is said that the Legislature never uses any unnecessary word/(s) while making laws and that each word has to be given due importance while interpreting and implementing the said law. The word repairs means to preserve and maintain an asset. But all repairs cannot be treated as current repairs. Secondly, the expression current repairs does not mean and include repairs which result in acquisition of a new asset or obtain a new advantage. Courts have held that current repairs are necessary repairs which are needed for the maintenance of building and machinery, etc., that they are not luxury repairs, the element of need being implicit in the expression, that whether a particular repair carried out was an essential repair or not should be judged from the viewpoint of commercial expediency and not by academic or theoretical standards, that primarily, it is for the businessman to decide when his building or machinery, etc., require repairs, that if, by carrying out the repairs, a new asset or an advantage of enduring nature is created, the expenditure on such repair cannot be regarded as an expenditure on current repairs.

The *Explanation* to section 30 is applicable from 1-4-2004 and it stipulates that current repairs should not include expenditure of capital nature. So, it can safely be said that for invoking the provisions of section 30 of the Act the twin conditions have to be satisfied – firstly, the amount spent should be in the nature of current repairs and secondly, it should not be in the nature of capital expenditure. In the case of *Surindar Madan (364 ITR 461),* the Hon'ble Delhi High Court found that the assessee had claimed deduction of an expenditure of ₹ 12.72 lakh incurred in replacing the floor of its entire office and factory premises with marble. Confirming the order of the Tribunal the Hon'ble Court held that non-marble flooring was ripped apart and was replaced in an area covering 9,000 sq. ft. with new type of flooring, that the new flooring was of different type and a distinct advantage of permanent character occurred. Finally, the claim made by the assessee was rejected, as it was found not to be a case of current repairs. On the other hand in the case of *HI Line Pens Pvt. Ltd. (306 ITR 182)* the Hon'ble Delhi Court allowed an expenditure of ₹ 14,03,835/- towards renovation of rented premises u/s. 30(a)(i) of the Act. Upholding the order of the Tribunal, the Hon'ble Court held as follows:

> *"There is a clear distinction between the expression 'repairs' and the expression 'current repairs'. The word 'repairs' is much wider*

> *than the expression 'current repairs'. The expression 'current repairs' is much more restricted than the word 'repairs' because the latter is qualified by the word 'current'.... . that the replacement was not of the premises but of certain 'parts' such as the internal wires and GI pipes. The analogy of replacement of the entire machine was not applicable to the case of the assessee. It was not the intention of the assessee to bring about any new capital asset. The expenses incurred by the assessee were towards repairing the premises taken on lease so as to make them more conducive to its business activity. Such expenses could fall within the expression of repairs to the premises as appearing in section 30(a)(i). Once the assessee's claim falls within that provision there was no question of considering the question of applicability of section 32. Thus, the Tribunal rightly agreed with the view taken by the Commissioner (Appeals) and held in favour of the assessee."*

The Act makes a clear distinction between the owner of the building and the tenant of a building for allowing expenditure u/s. 30 of the Act. The reasons are not difficult to comprehend. The Legislature has used different language in the provisions of section 30(a)(i) and section 30(a)(ii) of the Act. Where, a tenant is entitled to deduction of the amount spent on account of the cost of repairs to the premises, when he undertakes to bear the cost of the repairs. But, if the amount is spent by the assessee otherwise than as a tenant, the amount paid by him on account of only 'current repairs' is allowable. The latter provision applies to the assessee occupying the premises otherwise than as a tenant, as an owner or mortgagee in possession, and in those cases the deduction is restricted in respect of the 'current repairs' to the premises. So far as a tenant is concerned, it is the 'repairs' to the premises and if the assessee has undertaken to bear the cost of the repairs to the premises, then those repairs may be even in the nature of capital expenditure. Higher Judicial forums are of the opinion that the question of the repairs has to be considered in the larger context of business necessity or expediency. If the expenditure incurred by the assessee is so related to the carrying on or to the conduct of the business that it might be regarded as an integral part of the profit-earning process, then it is not for purposes of securing to the assessee a capital asset. The expenditure on the repairs of the building, which ultimately belongs to the owners, and not to the assessee, cannot be said to be in the nature of capital expenditure. It is possible that the assessee may obtain an advantage in a commercial sense by redesigning the premises and providing better fittings, better material. But, then the advantage to be obtained by the assessee will be for the purposes of the business of the assessee and not for the acquisition of a capital asset. So, it can be safely held that an expenditure incurred by a tenant towards repairs, even though it might be in the nature of capital expenditure, would be in the nature of allowable expenditure u/s. 30(a)(i), if it is in relation to the 'commercial activity of the assessee. In the case of *HI Line Pens Pvt. Ltd. (306 ITR 182),* the Hon'ble Delhi Court has held that there is a distinction between expenses incurred by a tenant for 'repairs' of the premises and the expenses incurred by a person who is not a tenant towards 'current repairs' to the premises. A tenant would, by the very nature of his status as a tenant, not undertake expenditure as would endure beyond his likely period of tenancy or create a new asset, whereas an owner may undertake expenditure so as to even bring about new assets of capital nature.

In the matter of *Girdharidass And Sons (105 ITR 339),* the Hon'ble Allahabad High Court has dealt with the issue of allowing expenditure u/s. 30 for a building rented by an assessee. In that matter the assessee, who was carrying on business in a rented building, carried out repairs to the building with the consent of the landlord. The Appellate Tribunal was of the view that the assessee must have made some structural changes in the shop and held that the expenditure was allowable neither as an expenditure on current repairs u/s. 30(a) (i)of the Act, nor u/s. 37, as it was an expenditure of capital nature. On a reference the Hon'ble Court held that expenditure incurred by an assessee on renovating, furnishing or remodelling of a business premises can be allowed as deduction u/s. 37, if the expenditure is not of capital nature. When an owner incurs expenditure on addition or alteration in a building which enhances its value, the expenditure can be of a capital nature. If further held that but if a tenant incurs an expenditure on a rented building for its renovation or alteration, he does not acquire any capital asset, because the building does not belong to him. Ordinarily, such an expenditure will be a revenue nature. To hold otherwise would amount to denying him the benefit of deduction of the expenditure at all because he will not be entitled to any depreciation allowance. Clearly, the assessee had not acquired an asset by incurring an expenditure on the rental shop. ….

Interests of business are always considered 'paramount, while applying the provisions of section 30 of the Act. In the matter of Allied Metal Products, it was found that the assessee was carrying on business in premises leased for 5 years and that it was bound to keep and restore building and machinery in 'good condition'. Though there was no written agreement to bear cost of repairs, yet the assessee repaired the leaky roofs and carried out extensive repairs necessary to keep building in good condition during lease. Allowing the appeal filed by the assessee, the Hon'ble *P & H Court (137 ITR 689)* held that no specific agreement was necessary for effecting repairs and that the expenditure incurred by assessee on repairs to roofs was allowable under section 30 of the Act and the repairs to premises was a revenue expenditure. Paramouncy of business was referred to by the Hon'ble Court to decide the issue in favour of the assessee. Expenditure on rent in respect of the guest house was allowable u/s. 30 and the expenses on repairs and polishing of the furniture in the guest house were allowable u/s. 31. They could not be disallowed under the provisions of section 37(3); *(177 ITR 214 Bom.)*

Municipal tax is a recurring liability and has been specifically made an allowable deduction under section 30(b) of the Act. In the case of *K. M. Selected Coal Co. (1 ITC 281, dtd. 21-12-1923)* it was held by the Hon'ble Patna High Court that if it was necessary to make payment of 'local rates' in order to carry on business it had to be allowed.

Certain expenses are not allowable under the head rent, repair, taxes. Expenditure incurred towards renewal of an asset cannot be held to be expenses on repair, hence same has to be disallowed. Similarly, taxes paid under the Kerala Building Tax Act, 1975 or under Building Tax Act of any State cannot be allowed u/s. 30 of the Act. As section 105 of the Transfer of Property Act, 1882, makes a distinction between rent and premium payable under a lease. So, when the interest of the lessor is parted with for a price, the price paid is premium or salami and same does not fall in the category of allowable expenses u/s. 30 of the Act. Hire charges paid for advertisement on hoardings would not come within the ambit of use of the premises for the purposes of business and hence cannot be allowed as rent paid u/s. 30 of the Act. *(349 ITR 317)*. Section 30 has nothing to do with advertisement, publicity or sales promotion.

Repairs and Insurance of Machinery, Plant and Furniture: Section 31

Expenditure incurred, for repairs and insurance of machinery, plant or furniture i.e., excluding buildings, used for the purposes of the business or profession, is the subject matter of section 31 of the Act. On a plain reading of the said section, it is clear that in order to entitle an assessee to claim deduction u/s. 31 of the Act, the amount must be paid on account of 'current repairs'. In commercial parlance, it means repairs which are undertaken in the normal course of user for the purpose of preservation, maintenance or proper utilisation. It does not mean 'petty repairs' or repairs necessitated by wear and tear during the particular year. Payments on account of 'current repairs' must be understood in contradistinction to payments for 'additions' or 'improvement'. The object of the expenditure should not be to bring a new asset into existence or to obtain a new or different advantage. The quantum of expenditure incurred on the repairs is not relevant for determining whether it is an expenditure on current repairs or not, because the extent of repairs and the amount spent would depend upon various factors. Similarly, by the mere fact that old parts were replaced by new parts, it cannot be said that a new asset is brought into existence. Hon'ble Delhi High Court has, in the matter of *Volga Restraunt (253 ITR 405)* defined the term current repairs as under:

> *"The expression 'current repairs' in section 31 of the Income-tax Act, 1961, means expenditure on building, machinery, plant which is not for renewal or restoration. It is only for preserving or maintaining an already existing asset which does not bring a new asset into existence or does not give to the assessee a new or different advantage and they must be such repairs as are attended to as and when the need for them arises and the question as to when a building, machinery, plant or furniture requires repairs and when the need arises must be decided not by any academic or theoretical test but must be decided by the test of commercial expediency."*

It is true that u/s. 31 of the Act, the amount paid on account of current repairs to plant/furniture/ machinery used for the purpose of business or profession is to be allowed as deduction. But, the *Explanation* to section 31, added later on, qualifies the general rule by stating that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure. Several heads of expenditure are separately dealt with u/ss. 30 to 36 of the Act. If an item of expenditure falls within any of the categories indicated in sections 30-36, it is entitled to deduction in accordance with the provisions of those sections. But, any expenditure which does not fall within the scope of sections 30 to 36, but which may still qualify while computing the income charge -able under the head 'Profits and gains of business or profession', will be covered by section 37(1) of the Act. What is important to note is that under both provisions, namely section 31 as well as section 37(1), capital expenditure is excluded. If an amount paid on account of current repairs is in the nature of capital expenditure, section 31 cannot be invoked. Similarly, section 37(1) cannot also be invoked. The question whether an expenditure is capital or revenue would depend upon the facts and circumstances of the case.

Repair always involves renewal i. e., renewal of a part of the unit concerned. Repair is restoration by renewal or replacement of subsidiary parts of a whole unit. In finding out whether expenses are for current repairs, deductible u/s. 31 of the Act, the real test is the aim and object of the expenses. If the expenses are incurred in bringing into existence a new asset or in achieving an advantage or benefit of an enduring nature or in substantially replacing plant or machinery, the expenditure would not be allowable. On the other hand, if the expenditure is incurred in the continuous process of use or employment of plant or machinery it would be deductible. The Hon'ble AP High Court has in the case of *Nathmal Bankatlal Parikh And Company (122 ITR 168)* held that repair means restoration by replacement of subsidiary parts or the whole, that current repair does not mean petty repair, that repairs may be small or major, that if it is a major repair, it may involve considerable amount of money, that the amount of money spent alone cannot be a factor to determine whether the expenditure falls under current repairs or not, that it is the nature of the repairs carried out by the assessee that matters for grant of deduction.

Facts of the case of *Desai Bros (108 ITR 14)* were that the assessee was engaged in the business of manufacture of bidis and it replaced a petrol engine by a diesel engine in a truck which was being used in the business. Considering the facts of the case, the Hon'ble Gujarat High Court dismissed the appeal filed by the department and held that the expenditure did not bring into existence a new asset nor was there a substantial replacement or renovation of an existing asset, that the expenditure had been incurred in preserving and maintaining an asset for purposes of its business, that same was for 'current repairs' of the machinery of the assessee and was deductible.

In cases of brick kilns, it was found by the AO that kilns had originally been lined with ordinary bricks but for the year under consideration the assessee had incurred expenditure to line them with fire bricks which were 'superior to ordinary bricks both in respect of achieving the quantity of heat and of restoring the normal productive capacity of the kiln'. He rejected the claim made by the assessee and held that it was not a case of repairs. Dismissing the appeal filed by the Revenue, the Hon'ble Delhi High Court in the case of *Dyer's Stone Lime Co. (P.) Ltd. (136 ITR 8)* held that the brick kiln was the plant of the assessee and portions of the plant were getting worn out and damaged on account of high temperature and also as a result of material being dumped down with force, and periodical repairs were necessary to keep the plant in working condition……that the expenditure was not laid out with a view to improve the quality of the kiln or its efficiency. ……. that the expenditure incurred by the assessee on the kilns was allowable as current repairs.

In *Serikella Glass Works (P.) Ltd. (157 ITR 584)* the Patna High Court reiterated the principle, a reference of which is available in earlier paragraphs, while dealing with repairing of furnace used by glass industry. Deliberating upon the quantum of expenses, the Hon'ble Court held as under:

> *"The quantum of expenditure is not of much assistance in ascertaining whether repairs are of current nature or not. It is the nature of alterations, renovations, repairs, etc. , which is relevant. The quantum of expenditure may only be a rough and ready guide thereto but that is not the crux of the matter"*

Here, it would be useful to take note of the matter of *Ooty Dasaprakash (237 ITR 902)* also. Facts of the case were that expenditure was incurred for repairs and modernising the hotel and replacing the existing components of the building, furniture and fittings, with a view to create a conducive and beautiful atmosphere for the purpose of running the business of a hotel. Considering the nature of the work, it was held, by the Hon'ble Madras High Court, that it is an allowable expenditure, as it was a case of current repairs.

But, if the expenses are incurred other than for current repairs, the courts will not allow such expendture. In *Sri Mangayarkarasi Mills P. Ltd. (315 ITR 114),* the Hon'ble Apex Court rejected the claim made, u/s. 31 of the Act, by the assessee, who had installed totally new machinery and had claimed that the expenditure incurred by it was allowable as repairs. Negating its claim, the Hon'ble Court held that the entire textile mill machinery for spinning yarn could not be regarded as a single asset, replacement of parts of which could be considered to be for the mere purpose of 'preserving or maintaining' the asset. It was further observed

> *"All parts put together constitute the production process and each separate machine part is an independent entity. Replacement of such an old machine part with a new one would constitute the bringing into existence of a new asset in place of the old one and not repair of the old existing machine. In the case of textile machinery repair of a machine can at best amount to a repair made to the process of manufacture of yarn and cannot be said to be 'current repairs' within the meaning of section 31 of the Act."*

From the above, it is clear that in order to constitute current repairs, the expenditure must have been incurred to *preserve and maintain* an already existing asset, and the object of the expenditure must not be to bring a new asset into existence or for obtaining a new advantage. It is difficult to accept that for the purpose of determining the allowability of expenditure under the head 'Repairs' the entire productive apparatus of a manufacturing company be treated as one single asset and wholesale replacement of complete identifiable and distinct parts be regarded as a 'repair'effected to the production facility as a whole. While judging a claim for deduction under the Act the scope of the term 'repair' cannot be stretched beyond all recognition. Taking into consideration above principles, the Hon'ble Madras High Court, in the matter of *Madras Cements Ltd. (255 ITR 243)* held that the *Combidan Cement Mill* which the assessee had installed and which replaced four old cement mills, was a new cement mill, installed at a different location, was technologically superior, was far more efficient than the four mills together and was capable of delivering a recognisably superior product. The acquisition and installation of that mill, could not by any stretch of imagination be regarded as 'repair' to the four cement mills which were discarded and subsequently sold. The expenditure incurred by the assessee in installing and commissioning the new cement mill by the name Combidan Mills, in pursuance of a modernisation programme was not allowable u/s. 31 of the Act.

One more important aspect about allowing claim u/s. 31 is that expenditure on replacement of machinery is not determined by the treatment given in the books of account or in the balance-sheet. The claim has to be decided only by the provisions of the Act and not by the accounting practice of the assessee. *(302 ITR 10).*

Courts are taking a pragmatic approach considering the changing realities of business world. In the case of *Janakiram Mills Ltd.* *(275 ITR 403)*, it has been held that where there has been no capacity addition and the replacement has been made only to restore the machinery to its original state of efficiency so that the entire integrated manufacturing unit which is considered as a profit-making apparatus functions efficiently and produces quality products, the concepts of 'current repairs', 'modernisation' and 'expenditure laid out or expended wholly and exclusively for the purpose of the business' have to be interpreted following the principle of updating construction taking note of the business needs and commercial expediency *'especially in a competitive business environment created by the globalisation'* and not by applying *'old concepts'* of what is capital and what is revenue.

If it is found that after expiry of life span of machinery some amount is paid to extend its life and the cost of replacement would have been much more, then the expenditure incurred by the assessee would qualify for deduction u/s. 31 of the Act.

One of the leading matters dealing with section 31 of the Act is of *Saravana Spinning Mills P. Ltd. (293 ITR 201)* that was delivered by the Hon'ble Apex Court. Facts of the matter were that the assessee, a textile mill, engaged in the manufacture of yarn, spent certain amounts for replacement of ring frames which had worn out. It claimed deduction of the amounts spent for replacement u/s. 31(i) of the Act as current repairs. According to the assessee, the whole textile mill was a 'plant' and the ring frames were one of the 25 machines which constituted one single process and, therefore, replacement of the frames had to be treated only as a replacement of old parts which had become derelict and not replacement of a machine. The AO held that by the replacement the assessee had obtained an enduring benefit and the expenditure incurred constituted capital expenditure and not 'current repairs'. The FAA allowed the appeal of the assessee and his decision was affirmed by the Tribunal. On a reference, the High Court affirmed the decision of the Appellate Tribunal. Reversing the decision of the High Court, the Hon'ble Apex Court held that the manufacturing process in the textile mill was not one continuous integrated process; that to decide the applicability of section 31(i) the test was not whether the expenditure was revenue or capital in nature, but whether the expenditure was 'current repairs' that The basic test was to find out whether expenditure was incurred to 'preserve and maintain' an already existing asset, and the expenditure must not be to bring a new asset into existence or to obtain new advantage, that each machine including the ring frame was an independent and separate machine capable of independent and specific function and, therefore, the expenditure incurred for replacement thereof would not come within the meaning of 'current repairs'. Finally, the Hon'ble Court held that the replacement of the ring frame constituted substitution of an old asset by a new asset, and, therefore, the expenditure incurred by the assessee did not fall within the meaning of 'current repairs' in section 31(i).

Expenses other than the expenses allowable u/s. 37: Section 36

Section 36 is a residual section in respect of certain deductions which are to be made from the income of the assessee while arriving at the taxable income and that is why it is nomenclatured as 'other deductions'. Sub-section 1 of the section 36, in the year 1962, had eight clauses and those clauses were about premium paid in respect of insurance, any sum paid to an employee as bonus or commission, amount of the interest paid in respect of capital borrowed, any sum paid by the assessee towards a recognised provident fund or an approved superannuation fund, any sum paid by the assessee towards an approved gratuity fund, in respect of animals which have been used for the purposes of the business or profession otherwise than as stock-in-trade, bad debt and any special reserve. But, with the passage of time the section has become too bulky and presently it is having many a provisos/explanations. Sub section 1 has xvii parts and sub-section 2 mainly deals with bad debts. The section has become quite complicated. But the basic concepts have remained same.

Expenditure towards interest payment

One of the important clauses of sub-section 1 of section 36 of the Act is about interest payment. It is said that the expression 'for the purpose of business' occurring in section 36(1)(iii) of the Act is wider in scope than the expression 'for the purpose of earning income, profits or gains'. Availing loan facilities and paying interest for loans taken has been and are the normal commercial practices of business world. It is difficult to visualise a business being carried out without taking loans. As the interest expenses has to be allowed as a legitimate expenditure incurred for business purposes, so, it is but natural that a lot of litigation has taken place on this issue.

One of the old cases, dealing with interest payment controversy, was decided on 8-12-1927. In the matter of *M. T. T. K. M. M. S. M. A. R. Somasundaram Chettiar (2 ITC 505)* it was found that the assessee had borrowed money on which he had to pay interest. Out of the said loan, he remitted part of it to its foreign branch and did not deploy for its regular business. Considering these facts, the Hon'ble Madras High Court held that when someone remitted the loan amount or part of it to its foreign branch, it must be taken that object of borrowing money was to finance foreign branch and not to utilise the loan for its own business, that expenditure in respect of interest on borrowed capital had to be disallowed. Similarly, in the case of *Marolia and Sons (129 ITR 475)*, the Hon'ble Allahabad High Court held as follows:

> *"It is settled law that an assessee-firm cannot claim deduction of interest under cl. (iii) of section 36(1) on the amount of borrowed money which is not used for the purpose of the business……..".*

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One the other hand, in the case of *A. L. A. R. Brothers (3 ITC 209, dtd. 19-4-1928),* the Hon'ble Madras High Court allowed the interest expenditure when it was found that there was connection between the loan taken and the business. It was found the assessees had a banking business which was carried on with borrowed capital, that it also did business in piece goods and financed such business time-to-time with money borrowed by their banking business, that it would charge interest on such advances. As the piece goods business was unsuccessful it was discontinued. The AO rejected the claim made by the assessee under the head interest expenditure. Deciding the matter in favour of the assessee, the Hon'ble Court held that money was borrowed for purposes of business and was employed in businesses for its purposes until it was lost, that the assessee was entitled to claim interest expenditure as an allowable expenditure, that interest paid on that part of borrowed capital which it had put into piece-goods business could not be disallowed. In the case of *Nirma Ltd. (405 ITR 277)* the Hon'ble Gujarat High Court has upheld principle that any amount on account of interest paid becomes an admissible deduction u/s. 36 of the Act, if the interest is paid on capital borrowed by the assessee and the borrowing is for the purpose of business or profession. The judgment reads as follows:

> *"In order to claim deduction under section 36(1)(iii) of the Income-tax Act, 1961, all that is necessary is that the money, i.e., capital, must have been borrowed by the assessee, that it must have been borrowed for the purpose of business and lastly, that the assessee must have paid interest on the borrowed amount. All that is germane is whether the borrowing was, or was not, for the purpose of the business. The provision makes no distinction between money borrowed to acquire a capital asset or a revenue asset."*

One of the principles of 1922 Act, regarding interest payment, stipulates that where a capitalist partner advances money to the firm on condition that interest should be paid to him – whether the business of the firm results in profit or not, that the firm is entitled to claim an allowance for the interest paid on such capital, that it is immaterial whether such capital was advanced as initial capital or subsequently, that no distinction can be drawn between capital borrowed and capital contributed, that capital contributed by a capitalist partner is only capital borrowed from him by the firm, that there is nothing in the Act to suggest that interest paid on the initial capital invested in a firm cannot be the subject-matter of an allowance.

As per the judgment of *Bombay Burma Trading Corporation, Ltd. (1 ITR 152)* a sole surviving partner who succeeds to the business of the firm is not entitled to deduct the interest so paid by him to the retiring partners.

In the case of *David Sasoon & Co. Ltd.*, the Hon'ble Bombay High Court has held that there is nothing in law to prevent a partnership starting business without capital and there is nothing to prevent a partner or partners in such a case lending to the firm money which would bear interest deductible under relevant section (8 ITR 7).

If loan is advanced out of interest-free funds, available with an assessee, there is no question or justification of disallowing interest u/s. 36(1)(iii)of the Act. In the case of *Holy Faith International P. Ltd. (407 ITR 445),* similar issue was dealt with. During the course of assessment proceedings, the AO noticed that the assessee had an amount of ₹ 149,36,11,300/-standing as investments as share application money in various related concerns, but it had not shown any interest or return on such investments. He concluded that the investment was a colourable transaction of advance without any interest to its sister concern in the shape of share application money. He further held that the assessee had not been able to prove with evidence that interest-bearing funds were used exclusively for business purposes, that the expenditure of bank interest on cash credit limit, had to be disallowed and added to the income of the assessee. The FAA confirmed his order. But, the Tribunal deleted the disallowance of interest expenditure, as it found that there was sufficient interest free own fund with the assessee. Confirming the order of the Tribunal, Hon'ble P&H High Court held that the advance was made out of interest-free funds available with the assessee and there was no question of disallowing interest under section 36(1)(iii) of the Act. Similarly, in the case of *Max India Ltd. (398 ITR 209)*, the Hon'ble P&H High Court after considering the fact that the assessee had sufficient interest free funds held that there was justification in holding that it had advanced interest bearing funds to three of its subsidiary companies.

The AO cannot decide as to how much interest i.e., at what rate, an assessee should pay for the loans taken by him. It was found in the case of Shree Benzophen Industries Ltd., that the assessee had paid interest @15% on borrowed funds and had claimed deduction towards the interest expenditure. The AO was of the opinion that considering the bank interest that prevailed at the relevant time the assessee ought to have paid interest @12.5% and accordingly made addition for the excess payment of interest expenditure. Matter travelled up to the Hon'ble Gujarat High Court. Dismissing the appeal filed by the Revenue, the Hon'ble Court held that the Tribunal was right in deleting the addition made on account of interest expenditure @ 15%, that looking to the commercial expediency, it could not be said that the Tribunal had committed any error in deleting the addition. *(405 ITR 185).* The Hon'ble Allahabad High Court in the case of *Sahu Investment Mutual Benefit Co. Ltd. (396 ITR 595)* has held that once the genuineness of transactions of deposits or advances is not doubted and they are not shown to be fictitious or colourable, the mere fact that the assessee has paid interest at higher rates on amounts received/ deposits or realised interest at lower rates on advances/loans, would not disentitle the assessee to claim deduction u/s. 36(1)(iii), on any notional basis as that was impermissible. In the case of *Taparia Tools Ltd. (372 ITR 605)* the Hon'ble Supreme Court held as under:

> *"Under section 36(1)(iii) of the Income-tax Act, 1961, any amount paid on account of interest becomes an admissible deduction if the interest was paid on the capital borrowed by the assessee and this borrowing was for the purpose of business or profession. While examining the allowability of a deduction of this nature, the Assessing Officer is to consider the genuineness of the business borrowing …. . Once the genuineness is proved and the interest is paid on the borrowing, it is not within the powers of the Assessing Officer to disallow the deduction either on the ground that the rate of interest is unreasonably high or that the assessee had himself charged a lower rate of interest on the monies which he lent.*

Interest paid on moneys borrowed, which are utilised for payment of dividends to the share -holders of a company, is entitled to deduction u/s. 36(1)(iii) of the Act, as the payment of dividend is a part of the business of a company and one of its purposes and must be regarded as included in the connotation of the expression for the purpose of the business within the meaning of cl. (iii) of section 36(1). In the case of *Shree Changdeo Sugar Mills Ltd. (143 ITR 469)*, it was further held that the expression for the purpose of the business may take into account not only the day to day running of a business but several other matters. But, the interest paid on moneys borrowed for payment of taxes is not entitled to deduction u/s. 36(1)(iii).

In the case of *Reliance Utilities and Power Limited (313 ITR 340)* the Hon'ble Bombay High Court has laid down a major principle about interest expenditure. It held if there are funds available both interest-free and overdraft 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 investments.

Bonus

The two provisos of section 36(1)(ii) of the Act must be read together to understand the permissible deduction of bonus in correct perspective. The object of the clause is to encourage the management to pay bonus not only to the extent to which it is statutorily bound to pay to the employee but also in excess of that limit provided the payment is justifiable as a reasonable payment. The position, therefore, is that where bonus has been paid in accordance with the requirements of the Bonus Act to an employee covered by the Act, the amount so paid is an allowable deduction. If bonus or commission is paid in excess of what is required to be paid under the Bonus Act or if bonus or commission is paid to an employee not covered by the Bonus Act, the amount paid is not automatically allowable as a deduction. Deduction of such amount will be allowed only on the AO being satisfied that it is a reasonable payment when considered in the light of the three clauses (a) to (c) of the second proviso. In other words, the amount so paid must be justifiable by reason of the pay of the employee and the conditions of service, the profits of business or profession for the previous year and the general practice in similar business or profession. All the three conditions enumerated in clauses (a) to (c) of the second proviso are to be satisfied in order that the payment which is not required to be paid under the Bonus Act is to be regarded as a reasonable deduction. Pooja bonus or customary bonus is distinct and different from profit-sharing bonus which has now been codified in the Payment of Bonus Act, 1965. Section 17(a) of that Act enables an employer to deduct any such bonus paid to an employee in a particular accounting year from the profit-sharing bonus payable to him under the Act in that year. No machinery is seen provided in the Act for quantification of that bonus. The main aspects to be looked into are whether the payment has been made over an unbroken series of years and whether it has been paid for a sufficiently long period.

Provident fund or Superannuation Fund

Section 36(1)(iv) of the Act, states that the deductions provided in the clauses thereof 'shall be allowed' when computing income u/s. 28. Clause (iv) lists as so deductible, any sum paid by the assessee as an employer by way of contribution towards a recognised provident fund or an approved superannuation fund, subject to limits that may be prescribed for the purposes of recognition of these funds and subject also to such conditions as the Board might think fit to specify in cases where the contributions are not in the nature of annual contributions of fixed amounts or annual contributions fixed on some definite basis by reference to the income chargeable under the head Salaries or to the contributions or to the number of members of the fund.

A plain reading of section 36(1)(iv) and (v) makes it manifest that payments made by an assessee under both the sections are admissible, only if the employer pays the contributions towards a recognised provident fund, an approved superannuation fund or an approved gratuity fund. In the matter of *Sony India P. Ltd. (285 ITR 213)*, it was found that the assessee entered into an agreement with the LIC and made contributions towards gratuity and superannuation funds for the benefit of its employees, that it made an application to the Commissioner for approval of the fund under the Employees Group Gratuity Scheme (corporate and factory) which was approved by the Commissioner w.e.f. 30-9-1998, that approval for the superannuation scheme was granted by the Commissioner w.e.f. 14-10-1998. The assessee claimed that the contributions made by it were admissible deductions for the AY. 1998-99. But, the claim was rejected by the AO on the ground that the contributions to an unapproved fund did not qualify for deduction under section 36(1)(iv) and 36(1)(v). The Hon'ble Delhi High court, upholding the order of the Tribunal and dismissing the appeal of the assessee, held that it was common ground that the funds to which the assessee had contributed were not approved either during the year under consideration or at any time up to the date of making the contributions, that the contributions made did not qualify for deduction u/s. 36.

Failure on part of an assessees to pay employers contribution and employees' contribution with the statutory authorities after due dates of payment, has been deliberated upon by the courts in light of the provisions of section 36 of the Act. In the matter of *Popular Vehicles and Services Pvt. Ltd. (406 ITR 150)* it was found that the assessee had failed to pay the employees' contribution under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and the Employees' State Insurance Act, 1948 before the due date provided under the enactments and claimed deduction in the AY. 2008-09 for the employees' contribution belatedly paid in the previous year. Dismissing the appeal of the assessee, the Hon'ble Kerala High Court held that the employees' contribution was covered by clause (va) of section 36(1) and the deduction was restricted by the Explanation below it. It was further held that if the employer's contribution under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 and the Employees' State Insurance Act, 1948 for the financial year 2007-08 was paid after the year but before the date of filing of the return for that year, it was allowable as a deduction in the assessment year, *de hors* the fact that it was paid in the subsequent year. But, with regard to the employees' contribution collected from the employees, the Hon'ble Court held that moment the deduction in the salary of the employees was made, it would in effect be income of the assessee, as had been indicated in the definition of 'income' u/s. 2(24)(x). It was also observed that the employees' contribution towards the funds was regulated by sub-clause (x) of section 2(24) and clause (va) of section 36(1) and would not be affected by section 43B, that the *non obstante* clause of section 43B had no effect in so far as the employees' contribution which was specifically covered by clause (va) of section 36(1), that by virtue of the Explanation below clause (va), no deduction could be claimed, if the contribution had not been paid after collection from the employees by way of deduction from their salaries, within the due date under the labour welfare Acts. The deletion of a proviso under section 43B could not render otiose the Explanation u/s. 36(1)(va). It has to be noticed that contributions made towards provident fund and employees' State insurance paid after the due date, but before the filing of the return of income could not be disallowed u/s. 36(1)(va) of the Act. *(398 ITR 594)*

Bad debts

Law governing the bad debts has changed w.e.f. 1-4-1989. Now, for proving irrecoverability of debts, the assessee has to establish only one thing – he has to show that the debt was written off in the regular books of account. There is no need for him to establish that debt had become irrecoverable. *T. R. F. Ltd.* (<u>323 ITR 397</u>) is the leading case, delivered by the Hon'ble Apex Court, wherein the allowability of bad debts in light of writing off in the books has been explained exhaustively. But, by making provisions of bad debts only, in the books of account, the assessee cannot take advantage of the section 36(1). What is required by the section is actual write off and not mere making provisions. Regarding the bad debts, the Hon'ble Allahabad High Court has held that it is settled law that an assessee-firm cannot claim deduction of interest under clause (iii) of Sec. 36(1) on the amount of borrowed money which is not used for the purpose of the business, but is given to the partners for their personal use. (129 ITR 475). In case of *K. J. Somaiya And Sons Pvt. Ltd.*, it was found that the assessee was not carrying on business of money lending, even then it had made a claim about bad debts suffered by it for the said business. The Hon'ble Bombay Court, considering these facts held that claim made by the assessee was to be rejected, as the money was not lent by it in ordinary course of money lending business and that it would not qualify as bad debt. (155 ITR 605).

Clause (viia): Provision for bad and doubtful debts made by scheduled banks and others

Clause (vii) of the section 36(1) deals with any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year, where as clause (viia) is about provision for bad and doubtful debts made by scheduled bank/non-scheduled bank/co-operative bank other than a primary agricultural credit society/primary co-operative agricultural and rural development bank. There was lot of confusion in interpreting the clause viia r.w. clause vii. The Hon'ble Apex Court in the case of *Catholic Syrian Bank Ltd. (343 ITR 270)* deliberated upon the issue of interplay of these clauses and held as under:

> *"The provisions of sections 36(1)(vii) and (viia) of the Act, are distinct and independent items of deduction and operate in their respective fields. Bad debts written off, other than those for which provision is made under clause (viia), will be covered under the main part of section 36(1)(vii), while the proviso will operate in cases under clause (viia) to limit the deduction to the extent of difference between the debt or part thereof written off in the previous year and the credit balance in the provision for bad and doubtful debts account made under clause (viia). Thus, the proviso would not permit the benefit of double deduction, operating with reference to rural loans while under section 36(1)(vii).*
>
> *The language of section 36(1)(vii) of the Act is unambiguous and does not admit of two interpretations. It gives a benefit to all banks, commercial or rural, scheduled or unscheduled, to claim a deduction of any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year. This benefit is subject only to section 36(2) of the Act. The proviso to section 36(1)(vii) does not, in absolute terms, control the application of this provision as it comes into operation only when the case of the assessee is one which falls squarely under section 36(1)(viia) of the Act. The Explanation to section 36(1)(vii), introduced by the Finance Act, 2001, specifically excluded any provision for bad and doubtful debts made in the account of the assessee from the ambit and scope of 'any bad debt, or part thereof, written off as irrecoverable in the accounts of the assessee'. Thus, the concept of making a provision for bad and doubtful debts will fall outside the scope of section 36(1)(vii) simpliciter. Once the bad debt is actually written off as irrecoverable and the requirements of section 36(2) satisfied, then, it will not be permissible to deny such deduction on the apprehension of double deduction under the provisions of section 36(1)(viia) and the proviso to section 36(1)(vii).'*

The essence of the judgment is that scheduled commercial banks would continue to get the full benefit of the write off of the irrecoverable debt(s) u/s. 36(1)(vii) in addition to the benefit of deduction for the provision made for bad and doubtful debt(s) u/s. 36(1)(viia). Normally, a deduction for bad debt(s) can be allowed only if the debt is written off in the books as bad debt(s). But, in the case of rural advances, a deduction would be allowed even in respect of a mere provision without insisting on an actual write off. As this may result in double allowance in the sense that in respect of the same rural advance the bank may get allowance on the basis of clause (viia) and also on the basis of actual write off under clause (vii). This situation is taken care of by the proviso to clause (vii) which limits the allowance on the basis of the actual write off to the excess, if any, of the write off over the amount standing to the credit of the account created under clause (viia). After the above judgment all dust has settled down about actual write off and provisions for the provision made for bad and doubtful debt(s).

Clause (viia) can be termed a special clause, as deals with allowance of Provisions of bad debts in case of certain banking entities, in given circumstances.

All unspecified Expenses: Section 37

Section 37 is of general nature and it operates in a wide range covering all expenditure laid out or expended wholly and exclusively for the purposes of the business or profession, which is not capital in nature or personal expenses of the assessee. Section 37(1) of the Act is a provision of residuary nature and once a provision is found to be residuary in nature, the mere fact that a claim does not fall under any of sections 30 to 36 of the Act, will not automatically, make the claim unsustainable u/s. 37 of the Act. Section 37 of the Act is a general section for grant of deduction on certain accounts not enunciated in sections 30 to 36 of the Act. The expression 'in the nature of' used in section 37(1) of the Act does not intend to stultify a legitimate claim in accordance with the principles of accountancy and well-established commercial practice. If the expenses are not deductible u/ss. 30 to 36 of the Act, but the conditions prescribed u/s. 37 are satisfied, then such expenses are required to be deducted while computing the income. Therefore certain expenses which may not admissible under section 30(a)(i) of the Act could be admissible u/s. 37(1) of the Act.

As per the provisions of the section capital and personal expenses cannot be allowed for computing the taxable income. The seeds of concepts of disallowing any Capital or Personal expenditure and expenditure being *laid out or expended wholly or exclusively* for business was part of Act XXXII of 1860 also. Rule 9 of Schedule of the said Act provided that 'money to be allowed as allowable expenditure should be expended wholly and exclusively'. Preconditions, for allowing the expenditure under the 1922 Act (original provisions) was that the expenses should have been incurred 'solely' for the business purposes. The Act uses phrases wholly and exclusively. Thus, the wheel, from Act XXXII of 1860, had full circle by the time present Act came in to existence. The general principles applicable to business expenditure u/s. 37 of the Act are:

i. Provisions of the section are required to be construed liberally;

ii. Section takes into account not only the day-to-day running expenses of a business but also the rationalisation of its administration;

iii. It may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process and assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commencing or for the carrying on of a business;

iv. It may comprehend many other acts incidental to the carrying on of the business;

v. Unless there is express or implied prohibition under other provisions of the Act, if the expenditure is covered by the provisions of section 37, then the necessary deduction is required to be given;

vi. The words 'profits and gains' in trade are to be understood in their natural and proper sense, i.e., in a sense in which it is understood by a prudent businessman.

The Hon'ble Gujarat High Court in *Navsari Cotton & Silk Mills Ltd. (135 ITR 546)* had evolved some positive and negative tests to claim deduction of an expenditure under the head business expenditure. Even today, these test are very relevant to solve the knotty issue of allowance of expenses. There is no conclusive test to distinguish capital from revenue expenditure. Every case has to be decided on its own facts keeping in mind the broad picture

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of the whole operation in respect of which the expenditure has been incurred. The test to be applied to ascertain whether the expenditure is revenue or capital is not based on where the funds were drawn from. The broad parameters and tests, which have been laid down by various decisions are that there should be an enduring benefit, which should accrue to the assessee and there should be a creation of a new asset.

To be an allowable expenditure, within section 37(1), the money paid out or away (a) must be paid out wholly and exclusively for the purpose of the business or profession and further (b) must not be (i) capital expenditure, (ii) personal expenses or (iii) an allowance of the character described in sections 30 to 36. The word 'wholly' refers to 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. 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'. It has to be examined whether the expense has been incurred with the sole object of 'furthering the trade or business interest' of the assessee. *(B. K. Khanna and Co. (P.) Ltd. – 247 ITR 705, Del).* Wholly and exclusively" in 37 of the Act is even more exacting in its requirements than the test of reasonableness and necessity.

Commercial expediency, a theory evolved over the period of time, is a major deciding factor about allowability of expenses incurred. The expression commercial expediency is one of wide import and includes such items of expenditure as a normal and prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency. As early as year 1939, in the case of *Motiram Nandlal (6 ITR 10)* the principle was recognised by the Hon'ble Nagpur court as one of the established rule of tax administration. The term commercial expediency was explained by the Hon'ble High Court as under:

> *"In applying the test of commercial expediency to determine whether the expenditure was wholly and exclusively laid out for the purpose of the business, the reasonableness of the expenditure should be considered from the point of view of the businessman ……*

The term commercial expediency is not limited to an existing practice prevailing in any particular trade or business. Even if the incurring of an expenditure is not be supported by any prevailing practice, it would be taken to be for the purposes of the business, if commercial expediency justifies the spending.

Hon'ble Delhi High Court has, in the matter of *Punjab Stainless Steel Inds. (324 ITR 396),* held as follows:

> *The commercial expediency would include such purpose as is expected by the assessee to advance its business interest and may include measures taken for preservation, protection or advancement of its business interests. The business interest of the assessee has to be distinguished from the personal interest of its directors or partners, as the case may be. "*

In the matters falling under commercial expediency, the assessee is required not only to claim commercial expediency, but he has also to establish it with the help of the available material. The test of commercial expediency cannot be reduced to the shape of a ritualistic formula, nor can it be put in a water-tight compartment. The revenue authorities have to place themselves in the position of a businessman and find out whether the expenses incurred could be said to have been laid out for the purposes of the business. While defining the phrase commercial expediency, the Lucknow Bench of Hon'ble Allahabad High Court *(352 ITR*

8) has, in the case of *Sahu Enterprises Pvt. Ltd.,* held as under:

> *"The commercial expediency would include such purpose as is expected by the assessee to advance its business interest and may include measures taken for preservation, protection or advancement of its business interests. The business interest of the assessee has to be distinguished from the personal interest of its directors or partners, as the case may be."*

From the above, it is clear that commercial expediency and prudence of a businessman are inseparable. Neither the existence of an agreement nor the genuineness of the payment can tilt the scale, in favour of the assessee, if expediency on commercial basis is not established. In the case of *The Newtone Studios Ltd. (28 ITR 378)*, the Madras High has held as under:

> *…. In order that an expenditure may be one incurred wholly and exclusively for the purpose of earning, it is sufficient if it was incurred voluntarily and on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business…"*

The M. P. High Court in the case of *J. K. Agents (P.) Ltd. (142 ITR 126)* has held that in deciding whether an expenditure is for the purposes of the business, the test applied is of commercial expediency and principles of ordinary commercial trading, that if the expenditure is incurred to facilitate the carrying on the business of the assessee and is supported by commercial expediency, it does not matter that the payment is voluntary or not necessary or that it also enures to the benefit of a third party, that If the object is business promotion, the expenditure would still be wholly and exclusively for the purposes of the assessee's business even though some other object necessarily results, being inherent in the nature and quality of the expenditure.

On the other hand, if the expenditure is not incurred wholly and exclusively for the business,it will not be allowed – though it may result in indirect benefit to the business or profession of the assessee. In the matter of Malayala Manorama (405 ITR 249) it was found that the assessee, a newspaper and periodicals publishing house, had spent amount on construction of houses for poor in its centenary year. Reversing the order of the Tribunal, the Hon'ble Kerala High Court held as under:

> *"……..the assessee had a scheme for construction of houses for the weaker and poor sections of the society in connection with the centenary celebrations of the company. The finding of the Tribunal was that this act of the company helped the assessee to create tremendous goodwill and to increase the circulation of its newspaper and consequent escalation of revenue from advertisement. However it was the assessee's own initiative to provide houses for the poor, an act of charity, done in connection with its centenary celebrations. Although the assessee may have got popularity in carrying out the noble cause, with considerable expenditure, resulting in enhanced circulation, it could not be termed as an expenditure incurred wholly or exclusively for the business of the assessee under section 37.* ***The benefit derived by the business was only incidental and the assessee never intended it as a business promotion****. The expenditure hence could not be allowed under section 37, being not one "wholly or exclusively laid out or expended for the business" of the assessee."*

Closely related with the concept of commercial expediency is the principle of **standard of reasonableness and necessity** of the expenditure incurred. Courts are unanimous that Revenue Authorities should not enter the 'prohibited areas' of both the issues. It is the businessman and only the businessman who has to decide as whether or not there was any necessity to incur particular expenditure. From the very beginning of tax litigation, it has been accepted that for the purpose of earning the profits it is not a pre-requisite to show that expenditure was incurred due to some kind of necessity – it is for the assessee to conduct his business and to decide the necessity of incurring the expenditure. The Act does not clothe the departmental authorities with any power or jurisdiction to determine the reasonableness of the amount paid by the assessee. If factum of the payment is in doubt or is in dispute, an AO can disallow the expenditure incurred by the taxpayer. But, no disallowance can be made on the ground that, in the opinion of the AO or other taxing authority, the expenditure is 'unreasonably' high, either because spending does not, in the opinion of authorities, commensurate with reasoning or requirements of the business, or because the assessee could have run his business more profitably by incurring lesser amounts. In the case of the Hon'ble Court held as under:

> *"In order that an expenditure may be one incurred for the purpose of earning the profits but it is not necessary to show that it was incurred "of necessity" .... . In applying the test of commercial expediency, the reasonableness of the expenditure should be considered from the point of view of the businessman and not from the point of view of outsiders including the Income-tax Officer. The Revenue has no power to examine what they think was reasonable or to say what expenditure was necessary."*

Capital or Revenue expenditure

Considering the great diversity of human affairs and the ever increasing complicated nature of business operations, it is said that, it is difficult to lay down any single test that would apply to all situations to determine whether an expenditure is of the nature of capital or of revenue. In the case of *Tamil Nadu Magnesite Ltd. (407ITR 543),* the Hon'ble Madras High Court has summarised the principles governing the capital and revenue expenses in following manner:

> *"There is no conclusive test to distinguish capital from revenue expenditure. Every case has to be decided on its own facts keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. The test to be applied to ascertain whether the expenditure is revenue or capital is not based on where the funds were drawn from. The broad parameters and tests, which have been laid down by various decisions are that there should be an enduring benefit, which should accrue to the assessee and there should be a creation of a new asset."*

However, various judicial forums have deduced some broad criteria which can be applied for deciding this perplexed, most hotly contested question. They are:

1. An outlay is deemed to be capital when it is made for the initiation of a business or for extension of a business, or for a substantial replacement of equipment.

2. Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade.

3. It should be seen whether for the purpose of the expenditure any capital was withdrawn or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business.

4. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.

5. If the purpose is the acquisition of an asset or a right of a permanent character, the possession whereof is a condition precedent to the commencement or continuance of the business, the expenditure would be of a capital nature.

6. Where an expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment, the aim and object of the expenditure would determine whether it is a capital expenditure or a revenue expenditure. The source or manner of the payment would then be of no consequence.

7. If the expenditure is so related to the carrying on or the conduct of the business that it might be regarded as an integral part of the profit making process, it should be held to be revenue expenditure.

8. In order that an expenditure may be allowed under Act as an expenditure , it is not necessary that that expenditure must have been made with a view to produce profits in the year of account.

9. The principle that capital receipt spells capital expenditure or *vice versa* is simple but it is not necessarily sound. Whether a sum is received on capital or revenue account depends or may depend upon the character of the business of the recipient. Whether a payment is or is not in the nature of capital expenditure depends or may depend upon the character of the business of the payer and upon other factors related thereto.

10. Where expenditure is made for the initial outlay or for extension of a business or for a substantial replacement of the equipment, it is capital expenditure. Expenditure incurred while the business is going on which is not incurred either for extension of the business or for the substantial replacement of its equipment can be looked at either from the point of view of what is acquired or from the point of view of the source from which the expenditure is incurred.

11. The aim and object of the expenditure would determine the character of the expenditure and the source or manner of payment would then be of no consequence. It is only in cases where this test is of no avail that one may go to the test of fixed or circulating capital. If the expenditure incurred were part of the fixed capital it would be of the nature of capital expenditure and if it were part of its circulating capital, it would be of the nature of revenue expenditure. These tests are mutually exclusive and have to be applied to the facts of particular cases.

Considering the complicated nature of business operations one has to apply the aforesaid criteria one after the other. The question has to be considered in the light of the nature of the business and from the view-point of the ordinary businessman. It is essentially a question of fact. In the matter of *H. P. Global Soft Ltd.*, the *Hon'ble Karnataka High Court (349 ITR 462)* has, with regard to the capital and revenue expenditure, observed as under:

> *"Precise rules for distinguishing capital expenditure from revenue expenditure cannot be formulated. The line of demarcation is thin. Certain broad tests have, however, been laid down. Each case turns on its own facts. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. When an expenditure is made for acquiring or bringing into existence an asset or an advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment. Expenditure may be treated*

> *as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. By enduring benefit is meant enduring in the way that fixed capital endures. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. Similarly, where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment, such expenditure would be revenue expenditure. If for running the business or working it with a view to produce the profits, if expenditure is incurred, it is revenue expenditure."*

A dissertation can easily be submitted, for Ph.D. purposes, to highlight the items that fall under either of the heads.

Litigation Expenses

For carrying on business or protecting the interest of business an assessee may have to incur legal expenses. So, allowance/disallowance of litigation expenditure has been deliberated upon by the Courts considering the facts of the case. Deductibility of expenditure incurred for litigation depends upon the nature and purpose of the legal proceeding in relation to the assessee's business and cannot be affected by the final outcome of that proceeding. In the year 1938, the Hon'ble Calcutta High Court in the case of *Amrita Bazar Patrika (5 ITR 648)* found that the company met all the expenses in connection with the defence of the Editor, the Printer and the Publisher of the paper who were prosecuted and convicted for contempt of Court in respect of an article published in the paper. The company claimed that the expenditure incurred should be allowed in computing its assessable income. Deciding the issue against the assessee, the Hon'ble Court held that the contempt proceedings were against the Editor and the Printer, that the expenditure was primarily incurred by them, that there was no legal obligation on the company to reimburse them for the expenses they had incurred, that the expenditure in question was not incurred 'for the purpose of earning profits or gains' and consequently was not allowable. Where a firm of partners who had for a number of years been importing certain brands of whisky and brandy from a company in Calcutta claimed to deduct from their income-tax assessment the expenses incurred in successfully defending the individual partners and the manager of their liquor department against criminal charges of conspiracy to commit offences against the Excise Act brought against them in Calcutta, the Hon'ble Rangoon High Court held that that the sum could not be deducted either as a business loss, or as an expenditure, as the expenditure was incurred by persons to protect their good name *(8 ITR 100)*. Similarly, in the matter of *Magniram Bangor & Co.,* when it was found that expenditure incurred in defending a suit was not incurred for the purpose of earning the profits or gains of the year in respect of which assessment was being made, but was incurred to prevent a liability arising in the future, the Hon'ble Calcutta High Court confirmed the disallowances. *(9 ITR 573).*

But, in the case of *Mathuradas Mannalal (10 ITR 95)* the Hon'ble Nagpur High Court allowed the litigation expenses incurred by the assessee. Facts of the case were that the assessee had filed a suit to recover loss with regard to future contract losses. The Hon'ble Court held that the expenditure incurred by the assessee in avoiding a business liability was allowable in the year in which the expenditure was actually incurred. The expenditure incurred by way of legal fees for conducting income-tax appeals and legal fees paid to solicitors for appearing before the in connection revenue authorities with the threatened attachment of property in the course of recovery of income tax demands were considered to be expenditure incurred for the preservation and protection of the business and are incidental to business, necessitated and justified by commercial expediency, and is deductible. In the case of *Bilasrai Juharmal (HUF)*, the Hon'ble Bombay High Court held that legal expenses incurred by the assessee in connection with the suit which was intended for retrieving, preserving and protecting the assets of the firms in which it had a six annas share, would be considered to have been expended by it wholly and exclusively in connection with its business. The mere fact that the suit was to settle the disputes between the partners or that the reliefs claimed were for dissolution and accounts, could not be a deciding factor in such a case *(141 ITR 915)*. In Delhi Cloth and General Mills Co. Ltd. *(85 ITR 261)* the Hon'ble Delhi High Court held that expenses incurred for protection or preservation of business or trade (for carrying on propaganda to counter agitation in the country against the industry for imposition of a ban on the manufacture of Vanaspati or compulsory colourisation of Vanaspati oil)would certainly be an allowable deduction.

It will be useful to take note of the judgment of the Hon'ble Allhabad High Court, delivered in the case of *(148 ITR 418)*, wherein the Hon'ble Court held as under:

> *"It is well-settled that litigation expenditure incurred in resisting an attack on the structure and assets of a company is deductible. The question of such deductibility is not dependent upon the merit of the defence which the assessee has set up. The test is whether the expenditure was incurred in the character of the assessee as a trader. ……. In deciding whether a particular expenditure is capital or revenue in nature, what the courts have to see is whether the expenditure in question was incurred to create any new asset or was incurred for maintaining the business of the company. If it is the former, it is "capital expenditure". If it is the latter, it is "revenue expenditure".*

Allowability of donation to the political parties has been examined by the courts in various occassions. In the case of *Indian Steel & Wire Products Ltd. (69 ITR 379)*, the question for consideration was whether a contribution to a political party was an allowable expenditure. The Hon'ble Calcuttta High Court laid down that it could only be a voluntary donation and would not be an allowable expenditure under the said provision. A similar question was required to be considered by the Delhi High Court in *Orissa Cement Ltd. (73 ITR 14)*. In that case the assessee claimed deduction of ₹ 1 lakh contributed to a political party and contended that its factory was situated at a place far away from Calcutta and other places and the supply of coal, packing bags and cement entailed problems which were solved by the Government ruled by a Party and that the Government had given to the assessee an interest-free loan of ₹ 50 lakh and had also subscribed for ₹ 40 lakh worth of preference capital in the company and had also agreed to buy the entire cement for Hirakud Dam and since the said Party was the ruling party, the payment was motivated by commercial considerations. Hon'ble Delhi High Court ruled that the expenditure could not be allowed as a deduction because the assessee failed to show the link between its business and contribution made to the Party, that sometimes payments for political purposes might be for the purposes of the trade, that a link between the trade and the payment must be established, that same cannot be claimed as business expenses. In another case, donations given by the assessee to the Chief Minister's Drought Relief Fund were held to be voluntary donations and not to have any connection with his export business. The Courts are unanimous that any donations to political parties or Government sponsored funds with the object of gaining some advantage in future would not be a deductible expense; such an action would be opposed to public policy.

According to the **Explanation to section 37 (1)** of the Act, 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. The Hon'ble Karnataka High Court in the matter of *Millennia Developers (P) Limited (37 DTR 19)* held that Regulation fees paid to Municipal Authority for compounding of offence was in the nature of penalty and hence not allowable as per the explanation to section 37(1) of the Act. Similarly, payment of protection money to rowdies and Police was held to be illegal in the case of *Neelavathi & Others (322 ITR 643 - Kar).* In the case of *Kap Scan And Diagnostic Centre P. Ltd. (344 ITR 476)* the Hon'ble P & H High Court held that expenditure incurred on account of commission paid to practising doctors who referred patients to the assessee for various tests was illegal and against public policy, that the commission paid could not be allowed as a business expenditure.

Courts are of the view that if the payment is of penal nature it is not allowable, whereas a compensatory payment has to be allowed. In such cases nomenclature is not important what is important is the nature. In the matter of *Prakash Cotton Mills Private Limited (201 ITR 684)* the Hon'ble Supreme Court held that wherever an expenditure is found to be of a composite nature, that is partly compensatory and partly penal, the authorities are obligated to bifurcate the two components of the impost. It further held that deduction had to be given to the component, which is compensatory in nature and disallow the deduction for the component which is penal in nature. Another important case with regard to nature of payment is *M/s. Regalia Apparels Pvt. Ltd. (ITXAL No. 88 of 2013 – Bom.).*

One very important thing to be remembered is that expenditure claimed by an assessee can be disallowed invoking the provisions of explanation, but, loss suffered by him is not covered by the explanation. In the case of *Dr. T. A. Qureshi (287 ITR 547),* it was found that the assessee, a medical practitioner, had claimed deduction of the value of heroin seized from his gross income, that the Department denied the deduction, that the Appellate Tribunal held that heroin was a part of his stock-in-trade and hence the assessee was entitled to claim deduction of the estimated value of the heroin as a business loss. On appeal the High Court held that the rigours of the *Explanation* to section 37 of the Act, was fully satisfied, that possession of heroin was an offence, that it was disgraceful for a doctor to indulge in activities against humanity, that the question of claiming deduction of the value of the seized article did not arise. Reversing the decision of the High Court, the Hon'ble Apex Court held that the *Explanation* to section 37 had no relevance as this was not a case of business expenditure, but was one of business loss, that business loss was allowable on ordinary commercial principles in computing the profits, that the heroin seized formed part of the stock-in-trade of the assessee, that the seizure and confiscation of such stock-in-trade had to be allowed as a business loss, that even though the assessee was committing a highly immoral act in illegally manufacturing and selling heroin, the case had to be decided on legal principles and not on one's own moral views.

Chatvari Aryasatyani of business expenses, can be summarised as under:

1. If business/profession is to be carried out, expenses will have to be incurred,
2. Litigation between the taxpayers and tax administrator is bound to take place about the allowability of expenditure
3. Expenses having direct and intimate relation with the business have to allowed, but payments made against the public policy are not allowable
4. Onus is always on the assessee to prove the factum of incurring of expenditure and establishing nexus between the business and the spending.

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CA Pramod Shingte

Concept of losses under the Income-tax Act, 1961

Every developing country's economics is set on sound principles/canons of taxations. There are various models of taxation but the preferred model of taxation in various jurisdictions is progressive system of taxation which means a person having larger income should contribute more to the public exchequer in comparison to the person having lesser income.

In the said situation, it has been envisaged that if a person has profits/income he should pay taxes if he has profit and losses simultaneously he should pay tax on net profit after deducting the losses and if he has resultant loss or only loss he is not required to pay taxes. However, due to the complexity and need it has been thought of to incorporate the provisions relating to set-off and carry forward of losses, but of course with certain restrictions.

Statutory Provisions

A. The set-off and carry forward of losses can be sub divided into two broad categories:-

1. Set off of losses.
2. Carry forward and set-off of losses.

1. Set-off Losses

Set-off of losses means adjusting the losses against the profit/income of that particular year. Losses that are not set-off against income in the same year, can be carried forward to the subsequent years for set-off against income of those years. A set-off could be:

a. An intra-head set-off

b. An inter-head set-off

a. An intra-head set-off (section 70)

According to section 70, if there is a net result of loss from any source of income during any assessment year the loss can be set off against the income of any other source within same head of income.

Exceptions:

1. Loss from speculation business.
2. Long term capital loss w.e.f. AY 2004.
3. Loss from activity of owning and maintaining race horses.
4. No loss can be set-off against gains from winning from lotteries, crosswords, puzzles, card games or other gambling.

b. An inter-head set-off (section 71)

According to section 71, if there is a net result of loss in respect of any head of income during any assessment year the loss can be set-off against the income of <u>any other head of income</u>.

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Exceptions

- Loss from speculation business
- Losses under head capital gains
- Losses from the business of owning and maintaining of race horses
- Loss from business/profession cannot be set of against income under head salaries
- Loss from exempt income (loss of profit must be loss of taxable profit)
- No loss can be set off against gains from winning from lotteries, crosswords, puzzles, card games or other gambling (section 58(4))

B. Carry Forward and Set-off of Losses

After making the appropriate and permissible intra-head and inter-head adjustments, there could still be unadjusted losses. These unadjusted losses can be carried forward to future years for adjustments against income of these years. The rules as regards carry forward differ slightly for different heads of income. These have been discussed here:

C. Losses from House Property: (Section 71A)

- Can be carried forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from house property
- Can be carried forward even if the return of income for the loss year is belatedly filed.
- The maximum loss from house property which can be set-off against income from any other head is ₹ 2 lakh

D. Losses from non-speculative business (regular business) loss

- Can be carried forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from business or profession
- Not necessary to continue the business at the time of set-off in future years
- Cannot be carried forward if the return is not filed within the original due date.

E. Speculative Business Loss

- Can be carried forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against income from speculative business
- Cannot be carried forward if the return is not filed within the original due date
- Not necessary to continue the business at the time of set-off in future years

F. Specified Business Loss under 35AD

- No time limit to carry forward the losses from the specified business under 35AD
- Not necessary to continue the business at the time of set-off in future years
- Cannot be carried forward if the return is not filed within the original due date
- Can be adjusted only against Income from specified business under 35AD

G. Capital Losses

- Can be carried forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Long-term capital losses can be adjusted only against long-term capital gains
- Short-term capital losses can be set-off against long-term capital gains as well as short-term capital gains
- Cannot be carried forward if the return is not filed within the original due date

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- Net loss under the head capital gains cannot be set-off against income under any other head

H. Losses from owning and maintaining racehorses :

- Can be carry forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Cannot be carried forward if the return is not filed within the original due date
- Can only be set-off against income from owning and maintaining racehorses only
- A taxpayer incurring a loss from a source, income from which is otherwise exempt from tax, cannot set-off these losses against profit from any taxable source of income
- Losses cannot be set-off against casual income i.e., crossword puzzles, winning from lotteries, races, card games, betting etc.

I. Explanation to Section 73

Where any part of the business of a company consists of sale and purchase of shares, such company for the purposes of section 73, be deemed to be carrying on a speculation business to the extent to which the business consists of sale and purchase of shares.

This shall not apply to the following companies:

- Investment company i.e., the company whose total income mainly consists of income from house property, capital gains and income from other sources
- Company whose principal business is of banking or of granting loan & advances

Points to be noted

- Penalty for non-performance of a contract cannot be treated as speculative loss
- The purchase and sales of shares against delivery will also constitute speculative business
- The shares are different from units of mutual funds/UTI
- The loss on sale of units will be treated as normal loss
- Brought forward depreciation, capital expenditure on scientific research & family planning
- Set-off & carry forward of losses under above heads are governed by section 32(2) of the Income-tax Act, 1961. Accordingly these can be carried forward indefinitely.
- The depreciation can be carried forward even if return is not filed in time. {Haryana Hotels, Punjab & Haryana H.C.}**[2005] 276 ITR 521**

J. Carry forward and set-off of losses & depreciation in case of amalgamation, conversion, merger & demerger, (Section 72A, 72AA, 72AB):

As a matter of general principle the carry forward & set-off is permitted to a person who has incurred these losses. However, there are exceptions to this rule as under:

1. Amalgamation of companies
2. Demerger
3. Conversion of proprietary concern/firm into a company
4. Amalgamation of a banking company with banking institution
5. Merger/Demerger of co-operative banks

1. Amalgamation

a. Eligible assessee
    1. Company owing industrial undertaking (see note below) or a ship or a hotel
    2. Banking company under Banking Regulation Act, 1949 with a specified bank
    3. Public sector airlines with other public sector airlines.

b. The amalgamating company has been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed for 3 years or more years.

c. The amalgamating company has held continuously as on the date of amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation.

d. The amalgamated company continues to hold at least three-fourths of the book value of fixed assets of the amalgamating company which it has acquired as a result of amalgamation for five years from the effective date of amalgamation.

e. The amalgamated company continues the business of the amalgamated company for a minimum period of 5 years.

f. Any other condition as may be prescribed.

   If the above specified conditions are not fulfilled, then that part of brought forward loss and unabsorbed depreciation which has been set-off by the amalgamated company shall be treated as the income of the amalgamated company.

Note: – Additional conditions under Rule 9C for industrial undertaking:

a. The amalgamated company, owning an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least 50% of the installed capacity within 4 years from the date of amalgamation and continue it till the end of 5 years from the date of amalgamation. However, the C.G. may relax the condition of minimum level of production or time period in suitable cases having regard to genuine efforts made by the amalgamated company to attain the prescribed level of production and the circumstances preventing such conditions.

b. The amalgamated company shall furnish to the AO a certificate in Form No. 62, duly verified by an accountant, with reference to the books of account and other documents showing particulars of production, along with return of income for the assessment year relating to the previous year during which the prescribed level of production is achieved and for subsequent assessment years relevant to the previous year falling within 5 yrs from the date of amalgamation.

2. Demerger

In case of demerger, the accumulated loss and unabsorbed depreciation of the demerged company will be allowed to be carried forward and set-off in the hands of the resulting company.

Central Govt. may specify conditions as it consider necessary to ensure that demerger is for genuine business purposes.

Computation of loss/depreciation to be carried forward to the demerged company

If the loss/depreciation is directly relatable to the undertaking transferred to the resulting company, them such loss/depreciation shall be allowed to be carried forward in the hands of the resulting company.

Where however, such loss/depreciation is not directly relatable to the undertaking transferred to the resulting company, them such loss/depreciation it will be apportioned between the demerged and the resulting company.

3. Loss in case of conversion of proprietary concern/firm into a company (Section 72A (4))

Sub-section (4) has been inserted with effect from the A.Y. 1999-2000 which states that in case of succession of a business where a firm is succeeded by a company fulfilling the conditions u/s. 47 (xiii) or a proprietary concern is succeeded by a company fulfilling the conditions u/s. 47 (xiv), the accumulated loss and the unabsorbed depreciation of the predecessor firm or proprietary concern as the case may be, shall be deemed to be the loss and unabsorbed depreciation for the successor company for the previous year in which the business reorganisation took place.

If the specified conditions u/s. 47(xiii) and 47(xiv) are not complied with, then brought forward loss and unabsorbed depreciation which has been set off shall be treated as the income of the successor company chargeable to tax in the year in which such conditions are not complied with.

One of the conditions for carry forward of the loss of the firm is that the aggregate of the shareholding in the company of the partners of the firm is not less than 50 per cent of the total voting power in the company and their shareholdings continue to be as such for a period of 5 years from the date of the succession.

4. Amalgamation of a banking company with banking institution

Section 72AA has been inserted with effect from the A.Y. 2005-06 for providing carry forward & set-off of the accumulated loss and the unabsorbed depreciation of a banking company, against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.

Section 72AA would be applicable if the following conditions are satisfied:

1. There is an amalgamation of a "banking company" with any other "banking institution". Banking company for this purpose means a company which transacts the business of banking in India. A banking institution for this purpose means any banking company and includes State Bank of India or a scheduled bank.
2. The amalgamation is sanctioned and brought into force by the Central Government u/s. 45(7) of the Banking Regulations Act, 1949.
3. The provisions of Section 72A sub-section 2(1b) (i)/(ii)/(iii) may or may not be satisfied.

It needs to be noted that accumulated loss does not include speculative business loss.

5. Accumulated loss and unabsorbed depreciation allowance in business reorganisation of co-operative banks (Section 72AB, w.e.f. AY 2008-09)

The successor co-operative bank can set off and carry forward loss and depreciation allowance of the predecessor co-operative bank if following conditions are satisfied:

A. The predecessor has been engaged in the business of banking for three or more years.

B. The predecessor has held at least ¾ of the book value of fixed assets of the predecessor acquired through business reorganisation, continuously for a minimum period of 5 years immediately succeeding the date of business reorganisation.

C. The successor continues the business of the predecessor for a minimum period of 5 years from the date of business reorganisation.

D. The successor fulfils such other conditions as may be prescribed.

There are certain other conditions which are as follows:

The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in following manner:

(i) In the case where whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertaking transferred to the resulting co-operative bank – the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.

(ii) In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank – the amount which bears the same proportion of the accumulated loss or unabsorbed depreciation of the demerged co-operative bank bears to the assets of the demerged co-operative bank.

Period before and after business reorganisation to constitute two different previous years: the period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the setoff and carry forward of loss and allowance of depreciation.

Section 78: Carry forward and set off of losses in case of change in the constitution of firm or on succession:-

K. Section 78(1): Change in the constitution

When a change has occurred in the constitution of a firm, then nothing shall entitle the firm to have carry forward and set-off so much of the loss proportionate to the share of the retired or deceased partner as exceeds his share of profits, if any, of the previous year in the firm. No partner can also avail the benefit of the said loss.

L. Section 78(2): Succession

Where any person carrying on any business or profession has been succeeded to in such capacity by another person otherwise than by inheritance, nothing in the chapter VI shall entitle any person other than the person incurring the loss to have it carried forward and set off against his income.

M. Special provisions for set-off & carry forward of losses in case of certain companies (Section 79)

1. Applicable to companies in which the public is not substantially interested.
2. There has been a change in the shareholding pattern in the previous year.
3. No loss incurred prior to the previous year unless:
   a. At least 51% shares must be held by the previous beneficial owners having voting power in the year in which the loss was incurred.
   b. Nothing contained in this section applies in case of death of a shareholder or gift by a shareholder to his relative.
   c. Nothing contained in this section will apply to an Indian company which is a subsidiary of a foreign company on account of amalgamation or demerger of the foreign company.

N. Sec. 80: Submission of return for losses

If a return has not been filed in accordance with Section 139(3), the loss shall not be carried forward & set off under Sections 72, 73, 74 & 74A.

Carry Forward and set-off of losses at glance

Carry Forward & Set-off of Losses	Set-off during the year			Carry forward & Set-off next year(s)		
Type of Income	**Same head**	**Another head**	**Against**	**C/F**	**Years**	**Against profits from**
1. House Property	Yes	Yes	–	Yes	8 years	same head
2. Speculation Business	Yes	No	From Speculation Profits	Yes	4 years	Same/another Speculation Business
Unabsorbed Depreciation/Cap Exp on SR/FP	Yes	Yes	Any income	Yes	No limit	Any income (other than salary)

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Carry Forward & Set-off of Losses	Set-off during the year			Carry forward & Set-off next year(s)		
Type of Income	Same head	Another head	Against	C/F	Years	Against profits from
Non-speculative Business or Profession	Yes	Yes (except salary)	Any Business Profits	Yes	8 years	Same head
3. Long Term Capital Losses	Yes	No	LTCG	Yes	8 years	LTCG
Short Term Capital Losses	Yes	No	STCG/ LTCG	Yes	8 years	STCG/LTCG
4. Owning/ Maintaining race horses	Yes	No	Same item	Yes	4 years	Same item
5. Income from Other Sources (except if exempt)	Yes	Yes	NA	No	NA	NA
6. Specified Business u/s. 35AD	Yes	No	Specified Business Profits	Yes	No Limit	Any Specified Business

O. Section 115BBE Amendment: Benefit of set-off of losses will not be available against income added back under Sections 68/69/69A/69B/69C/69D

Finance Act, 2016 with effect from assessment year 2017-18, has been amended to not allow setting off of losses against income charged to tax as unexplained credit/investments/money/expenditure.

P. Some Issues

1. Income under section 115BBD of the Act

Section 115BBD(2) of the Act reads as follows:

Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing its income by way of dividends referred to in sub-section(1).

Issue has been deliberated that what the meaning of the term "allowance" is. Whether the provisions intend to curtail the set-off of losses and unabsorbed depreciation against the dividend received from foreign company.

- The term "allowance" includes current year depreciation and unabsorbed depreciation as depreciation is referred as an allowance under section 32 of the Act.
- However, the term "Expenditure or allowance" in non-obstante clause u/s.115BBD(2) of the Act does not extend to include business loss, hence, a view is possible that unabsorbed depreciation cannot be set-off against the income taxable u/s.115BBD of the Act. But current year business losses can be set-off against such income. Alternatively, where losses are set off against the subsequent year's business

income, it could lead to a tax shield of 30% as against 15% in case the same is set-off against dividend income. Hence, set off of losses against subsequent year's income could be subject to contention.

2. Unabsorbed depreciation / loss deduction under sections 10A and 10B

The issue of set off of losses from the profit of eligible units under Chapter III has been quite controversial for some time. Further it had a flair also from the point of view of whether deduction under sections 10A, 10B etc., specified in chapter III are in the nature of deduction or exemption and what shall be the priority of adjusting the same

Typically the undertakings eligible to claim deduction under sections 10A, 10B etc., use to claim the entire amount of eligible business as exempt and any unabsorbed depreciation and business losses of non-eligible use to remain intact for carry forward and set-off in subsequent year. In such cases revenue was of the opinion that deduction under these sections must be given effect, only after setting-off the depreciation and business losses. The issue had travelled long way and now finally stands settled by Hon'ble Supreme Court in the case of *CIT vs. Yokogama India ltd. 2017 taxmann.com 41 (SC)* wherein Hon'ble Apex Court has held that the stage of deduction would be while computing gross total income eligible under Chapter IV and not at the computation of total income under chapter VI of the Act.

However in the current Section 10AA explanation has been inserted with effect from AY 2018-19 wherein it has been clarified that deduction under section 10AA shall be allowed from the total Income of the assessee and deduction shall not exceed total income.

3. Whether the long term capital loss from sale of equity shares (STT paid) can be set off against long-term capital gain from sale of land

Mumbai Tribunal in the case of *Raptakos Brett & Co. Ltd. vs. DCIT 3397/MUM/2009* has held that:

The concept of income includes loss will apply only when entire source is exempt or is not liable to tax and not in the case where only one of the income falling with in such source is treated as exempt.

Section 10(38) excludes in expressed terms only the income arising from transfer of long-term capital asset being equity share or equity fund which is chargeable to STT and not entire source of income from capital gains arising from transfer of shares. It does not lead to exclusion of computation of capital gain of long-term capital asset or short-term capital asset being shares. Accordingly, long-term capital loss on sale of shares would be allowed to be set-off against long-term capital gains on sale of land in accordance with section 70(3).

4. Losses can be set-off against income included under Section 64

Hon'ble Supreme Court in the case of *CIT vs. J. H. Gotla (1985) 156 ITR 323 (SC)* has held that:

Where Section 64 operates, profit/loss from business of spouse included in total income of assessee should be treated as profit/ loss of business carried on by him for carry forward and set off of loss under section 72 of the Act.

The provisions of set-off and carry forward of losses also applies to clubbed income.

Q. Conclusion

The importance of the loss carry forward provision to an assessee is that it preserves valuable cash which otherwise would have to be paid out of taxes. Such funds are retained in the business and can be used for working capital and/or expansion of fixed or other non-current assets; therefore these provisions play a very vital role in the process of computation of total income.

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Article 265 of The Constitution of India

Introduction

The well-known statesman of the 18th century Benjamin Franklin had once remarked that only two things are guaranteed in a democracy viz. death and taxes. A 'tax' is an exaction from the State/Government from the citizens to meet the expenses of the State and no Government can survive without taxes. The perspective of a 'tax' is that it is the State's share in the income of the citizen and the tax due to the State was referred to 'crown's debts'.

The common law doctrine of priority of crown's debts has been evolved by the special attributes associated with the Crown in England in early days. It is the part of the Crown's prerogative. As Halsbury has observed "the royal prerogative may be defined as being that pre-eminence which the Sovereign enjoys over and above all other persons by virtue of the common law, but out of its ordinary course, in right of her regal dignity, and comprehends all the special dignities, liberties, privileges, powers and royalties allowed by the common law to the Crown of England." This doctrine, as originally evolved by common law in England, had a very wide sweep and included within its scope many privileges and powers.

This common law doctrine is not in any way alien to Indian culture and Indian history. Reference can be made to the rule enunciated by Yajnavalkya in that behalf says Yajnavalkya,

> *"A debtor shall be forced to pay his creditors in the order in which the debts were contracted, after first discharging those of a priest or the King".*

Salient features

Even though 'tax' is crucial, it is necessary that the collection of tax is regulated otherwise the exercise of collection of taxes may get arbitrary, as had happened in the past under tyrannical governments. Arbitrariness has no place under democracy. The prime characteristic of a democracy is the doctrine 'Rule of Law' and this doctrine requires elimination of arbitrariness. With this objective, our Constitution provides for safeguards against arbitrariness and one such safeguard is Article 265. It provides that 'no taxes are to be collected, except by authority of law'. The article is worded negatively. And, therefore, every levy of any tax/cess/impost will have to have sanction of law. Here the word 'Law' means a substantive law i.e., Statute Law which is passed by the Legislative body

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viz., Parliament/State Legislatures *{S. Gopalan vs. State of Madras (1958) 2 MLJ 117}*. In other words, levy of tax cannot be by executive action *{Ramjilal vs. ITO AIR 1951 SC 97}*. This Article ordains that the procedure to impose any levy of tax/imposts has to be strictly complied with. *{Municipal Council vs. Kamal Kumar AIR 1965 SC 1321}*. Further a tax could be imposed only by a valid law. In order to be 'valid', the relevant law should comply with the requirements of the said Article. The requirements are as follows;

1) The law should be within the Legislative competence. viz., should be covered under the legislative list assigned to it by the Constitution *{See Poona Municipality vs. Dattaraya AIR 1965 SC 555}*. The Seventh Schedule to the Constitution provides three lists viz., Union List which contains subject matters on which only the Union Legislature (Parliament) and State Legislature can legislate. List I contains those subject matters on which the Parliament can legislate, List II covers those subject matters on which the State Legislatures are empowered to Legislate and List III is concurrent list viz., subject matters on which both the Union Legislature as well as the State Legislatures can legislate. For e.g., Taxes on 'income' can be imposed only by the Union Legislature – that is mandate of Entry no. 82 to List I. So State Legislatures cannot levy tax on income. If a State Legislature passes an Act levying tax on income, then such a law would be 'invalid'. But the Union Legislature has no power to levy tax on Agricultural income; only State Legislatures can do that. Similarly 'Education' is a State subject.

2) The law should not be prohibited by any of the Articles. *{Malayalam Plantations vs. DCIT AIR 1965 SC 161}*. For e.g., Art. 289 states that the Central Legislature has no power to levy tax on income of a State Government.

3) The 'Law' or any part of it should not be void under Article 13 viz., it should not conflict with the fundamental rights incorporated under Part III of the Constitution. So a 'law' may be invalid if it violates the fundamental right to equality guaranteed by Article 14 and

4) The 'law' should not violate any Constitutional limits such as Articles 301 and 304.

Similarly a taxing measure may be challenged if it violates the citizens' rights under Article 19(1) (f) or (g). In the case of *Khazan Chand vs. State of J & K AIR 1984 SC 762,* it was observed that the power to make a law w.r.t tax contemplates within it, the power to levy that tax, determine the persons who are liable to pay the tax, the rates of tax and the taxable event. Also the procedure for levy of tax should comply with the rigours of Article 265 as well. A very wide latitude is available to the legislatures in the matter of classification of objects, persons and things for purposes of taxation.

Difference between 'Tax' and 'Fee'

There is a difference between 'tax' and 'fee'. Article 265 applies to 'taxes' and not to 'fee'. A fee can be imposed by executive action. The difference between these two is that a tax is part of common burden whereas a fee is a payment for special benefit or privilege. If the element of revenue for the general purposes of State predominates, the levy becomes a tax. In case of a 'fee', there is correlation between the fee collected and the service rendered. Now sometimes the difference between the two may get blurred or there may even be a colourable exercise of power to levy a tax in the guise of a fee. In such a case, the courts will have to scrutinise the scheme of the levy carefully in order to determine whether the levy is 'fee' or a 'tax' disguised as a fee. However a fee could be voluntary or could be mandatory. Merely because it is mandatory, the character of the levy of that of a 'fee' does not change.

The essence of taxation is compulsion i.e., it is imposed under the statutory power without the taxpayers' consent and the payment is enforced by law. Taxation is an imposition for a public purpose without any special benefit flowing to the taxpayer while in case of a fee there is a correlation between the levy and the benefit/ service rendered. Further in case of a 'tax' the levy depends (generally) upon the capacity to pay which is not the case for a fee.

Article 265 and Article 32

Though Article 265 has utmost importance and it lays down that "No tax shall be levied or collected except by the authority of law, it is worth noting that it is not a part of Fundamental right as conferred by Part III of the Constitution. Thus, as a consequence, a levy or recovery of tax without any authority of law does not result in violation of fundamental rights and a writ petition under Article 32 to the Apex Court is not permissible. One may refer to the decisions of the Apex Court in the case of *Ramjilal vs. ITO [1951] 19 ITR 174 (SC)* and *Laxmanappa Hanumantappa Jamkhandi vs. UOI [1954] 26 ITR 754 (SC).* However at the same time, it cannot be lost sight of that levy or collection of tax on unreasonable classification or unjustified discrimination resulting in violation of Article 14 amounts to "violation of fundamental right" and in such a scenario, direct access to the Supreme Court under Article 32 is permissible.

Double Taxation and Article 265

Generally, it is stated that income must be taxed only once and it should not suffer any double taxation. Judicial forums from time-to-time reiterated it and laid down the principle that Courts must lean/adopt an interpretation which avoids double taxation. However at the same time the said decisions emphasised the State's power to incorporate provisions resulting in double taxation and carved out an exception to the general principle/understanding. It is to be noted that if the legislature with specific intent with unambiguous words distinctly enact provisions resulting in double taxation, the effect to the same must be given in toto. One may refer to the following decisions.

i. *ITO vs. Bachu Lal Kapoor Kewal Ram [1966] 60 ITR 74 (SC)*

ii. *Jain vs. UOT [1970] 77 ITR 107 (SC)*

iii. *Prince Azam Jha Bahadur vs. ETO [1972] 83 ITR 92 (SC) and*

iv. *Mahaveer Kumar Jain vs. CIT /[2018] 404 ITR 738 (SC)*

It is worth keeping in mind that Article 265 enunciates that "No tax shall be levied or collected except by the authority of law". Corollary to it suggests that once levy or collection of taxes is as per the authority of law, double taxation has no leg to stand provided provisions resulting in double taxation are clear, unambiguous and enacted with the specific intention. Such provisions cannot be considered to be in violation of Article 265.

Taxation of income in right hands in a right year

From Article 265, it is discernable that Income must be taxed in right hands in a right year and any deviation from the same will amount to its violation. To appreciate this concept in depth, let's deal with one example at this juncture. Mr. A and Mr. B own a residential house equally and derive rental income from the same. Since the share of Mr. A and Mr. B in the said property is in the ratio of 1:1, it is imperative that the rental income from the said property must be offered to tax by both the co-owners in equal proportion. However instead of doing the same, they adopt a different treatment. Mr. A offers the entire income in his hands and Mr. B does not include a single penny in his return of income on the contention that the tax on the entire rental income is paid by Mr. A and the State/Government has already received its due share of tax in the said transaction. Now the question comes for determination whether such a stand will hold the field. In the light of Article 265, the obvious answer to the aforesaid question is in negative. In the given example, as far as Mr. A is concerned, he has paid excess tax to the extent of 50% which ought to have been paid by Mr. B and any collection/retention of the same from Mr. A would result in collection/ recovery without any authority of law. Further the tax due from Mr. B as per the authority of law was never collected by the State. Thus, in such a scenario, it is obligatory on the part of the State to refund the excess portion to Mr. A and initiate appropriate proceedings against Mr. B for its recovery. It is of utmost importance to tax a particular income in hands of a right person in a right year who is liable to get taxed regarding the same. One may refer to the decision of Apex Court in the case of *ITO vs. Ch. Atchaiah [1996] 218 ITR 239 (SC)* where the Apex Court upheld the action of the assessing officer to tax capital gains in the hands of AOP who was liable to get taxed regarding the said capital gains despite the fact that both the members included the said capital gains equally in their respective returns. Subsequently following the said decision, once again, the Apex Court in the case of *Maneklal Agarwal vs. DCIT [2017] 396 ITR 721 (SC)* upheld the action of the assessing officer. However at the same time, the Apex Court observed that the same income cannot be taxed in the hands of two persons and it is always open to other persons to seek redressal in appropriate proceedings. It is worth clarifying at this juncture that though there is no explicit reference to Article 265 in the aforesaid judgments, it is clearly evident from the said judgments that interpretation/reasoning adopted by the Apex Court is on the exact lines and in true spirit of Article 265 emphasising on the ratio that a levy or collection must always be under the authority of law.

Doctrine of Estoppel and Article 265

To take the abovementioned discussion forward, a question arises for consideration whether the doctrine of estoppel is applicable to taxing statutes in the light of Article 265. To put it either way, in the taxing statues can a person be prohibited by adopting a different stand at a later stage? As we all know that the doctrine of estoppel prevents a person from adopting a different stand which is contrary to his earlier stand. However the same does not act as a bar in the taxing statutes and a person is entitled to take a different/new stand which is in consonance with the Act/law. If the same is not permitted, it will result in violation of Article 265 and in turn amount to levy or collection of tax without the authority of law. In taxing statutes, acquiescence cannot take away from a person the relief that he is entitled to. The said discussion can be understood in a better manner by way of an example. Suppose, a person has received the compensation for loss of his reputation which is not chargeable to tax being a capital receipt. However while filing a return of income, such receipt was offered to tax. Subsequently, in the assessment proceedings, the Assessing officer was requested to exclude the same while computing the total taxable income of a person. In such a scenario, though the said sum was already included by a person voluntarily on his own in the return of income, an assessing officer is under obligation to exclude the same while computing the total income for a particular year on account of an undisputed fact that it is not chargeable to tax in the first place. Inclusion of the said sum in the total income on the contention that a person himself offered the same in his return of income will clearly amount to levy as well as collection of tax except by the authority of law. When such a receipt does not fall within the ambit of "income", the State has no right to collect/ retain the tax paid on the same by its citizen on his own. It needs to be noted that Article 265 empowers levy of taxes only as per the law. So if a particular levy does not have the sanction of law, tax cannot be levied and subsequently retained/collected notwithstanding the fact that the assessee may have acquiesced to such a levy. Thus, the doctrine of estoppel is not at all applicable to taxing statutes since the same will result in violation of Article 265. One may refer to the decision of Bombay High Court in the case of *Nirmala L. Mehta vs. CIT [2004] 269 ITR 1 (Bombay)* in which it was held as under:

> *"There cannot be any estoppel against the statute. Article 265 in unmistakable terms provides that no tax shall be levied or collected except by authority of law. Acquiescence cannot take away from a party the relief that he is entitled, to where the tax is levied or collected without authority of law."*

Subsequently, the Bombay High Court while reiterating the abovementioned principle in the case of *Balmukund Acharya vs. DCIT [2009] 310 ITR 310 (Bombay)* held as under:

> *"Having said so, we must observe that the Apex Court and the various High Courts have ruled that the authorities under the Act are under an obligation to act in accordance with law. Tax can be collected only as provided under the Act. If any assessee, under a mistake, misconceptions or on not being properly instructed is over assessed, the authorities under the Act are required to assist him and ensure that only legitimate taxes due are collected. If particular levy is not permitted under the Act, tax cannot be levied applying the doctrine of estoppel."*

It is worth appreciating at this juncture that the true spirit of Article 265 is enshrined not only by judicial forums but also the CBDT in its various circulars. **Circular No: 14 (XL-35) of 1955 dated 11th April, 1955** is the classic example in which the CBDT mentioned as under.

> *"Officers of the Department must not take advantage of ignorance of an assessee as to his rights. It is one of their duties to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard the Officers should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him. This attitude would, in the long run, benefit the department for it would inspire confidence in him that he may be sure of getting a square deal from the department. Although, therefore, the responsibility for claiming refunds and reliefs rests with assessee on whom it is imposed by law, officers should—*
>
> *(a) draw their attention to any refunds or reliefs to which they appear to be clearly entitled but which they have omitted to claim for some reason or other;*
>
> *(b) freely advise them when approached by them as to their rights and liabilities and as to the procedure to be adopted for claiming refunds and reliefs.*

Thus, the doctrine of estoppel is not applicable to the taxing statutes since it is in direct violation of Article 265. The State is entitled to collect/hold taxes which are legitimately due from its citizens in accordance/under the authority of law. Any deviation from it will not only amount to violation of Article 265 but also unauthorised holding resulting in unjust enrichment on the part of the State.

Conclusion

To conclude, Article 265 is a protection to citizens against executive action. It ensures levy and collection of tax only under the authority of law and the same cannot be at whims and fancies of executives but shall only be at the behest of elected representatives of the people (Legislatures) which is the most crucial aspect in democracy. This protection is also necessary to ensure the enforcement of the "Rule of law" in the country.

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SS-VI-37

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Jurisdictional Errors – Curable and Non-Curable Defects

1. Introduction

Income-tax Act as an Administrative law contemplates a legal framework for its administration. While administering the provisions, it is required that the actions under the Act are taken strictly in accordance with the prescribed sanctions as laid down under the Act. Any action without prescribed sanction would lack validity and would fall into nullity. At the same time, the law consists of different procedures for the effective implementation of the Act. The procedures may be looked upon as merely directory and would be amenable for making good any inadequacy or irregularity if so done. This marks the very significant distinction within the errors which are non-curable and the one which are curable. The non-curable errors are construed as jurisdictional errors that go to the root of the action and become void. On the other hand curable errors being directory are to be cured or regularised. The identification and distinction of the provisions as falling into either of the category may be very critical and need to be construed looking at the scheme of the Act and the underlying legal principles. The study of these principles therefore is crucial. This write up therefore endeavours to discuss and analyse these principles highlighting some of the important specific contexts under the Income Tax Act where the test of jurisdiction can be applied.

2. Principles Governing Jurisdiction

It is a basic principle of administrative law that nobody can act beyond its powers. No authority can exceed the power given to it and any action taken by it in excess of its power is invalid. Thus when an authority is empowered to grant a permit for a period of three years, it cannot grant permit for five years. Lack of jurisdiction may arise when an authority has no jurisdiction over the subject-matter or the parties.

A jurisdictional error may arise when a body having jurisdiction fails to exercise the same. E.g. Assessment u/s. 147 can be reopened after recording reasons to believe and after obtaining due approval as per Section 151. If the authority does not record reasons or does not obtain the Approval from the Specific Authority prescribed under the Act, it would not get the jurisdiction to invoke the proceedings u/s. 147. If an authority is not properly constituted, then it cannot have any jurisdiction to act. If a Statute requires three members to constitute a Tribunal, a Tribunal composed of only two members will be acting without jurisdiction.

Lack of jurisdiction may also arise from absence of some preliminary or some particular fact collateral to the actual matter which the body concerned may have to try and is a condition precedent to the assumption of jurisdiction by it. Such a fact is known as "jurisdictional fact". Facts which must exist before an authority could exercise jurisdiction in a matter are jurisdictional facts. The existence of these facts is a condition precedent for the application of a statutory standard or the assumption of jurisdiction by a body over a dispute and to decide it on merits. "Reason to Believe" in Section 147 of the Income tax Act is tested on such jurisdictional fact.

A Statute may or may not give power to an authority to determine the jurisdictional facts for itself. When no such power is conferred, judicial review extends to consideration of the evidence by the Court upon its own independent judgment, as if it is an appeal and to decide the existence of jurisdictional facts. The reason for this approach is that the jurisdiction of the body depends on a correct decision as to jurisdictional facts and that by wrongly deciding a jurisdictional fact, a body cannot give jurisdiction to itself which it does not possess under the Law.

3. Waiver of Jurisdiction

Lack of jurisdiction cannot be cured by the consent of the parties. Even if a party submits to the jurisdiction of an authority, the party is not estopped from challenging latter on the ground that the authority acted without jurisdiction. The reason is that lack of jurisdiction goes to the root of the matter.

4. Error of Law vs. Error of Jurisdiction

Where an administrative action is challenged on account of jurisdictional error, the Courts are faced with the statutory interpretation. To determine whether an authority has exceeded its jurisdiction or not, it is often necessary for the courts to interpret the law and to intervene if the authority has not acted in accordance with their interpretation. A distinction is accordingly made between an "error of law affecting jurisdiction" and an "error of law going to the merits of the case". However, this distinction introduces an element of artificiality as it is not always rationally possible to distinguish between the two types of errors of law. Suppose an income tax authority, having power to impose tax on income and not on capital receipt, imposes the tax on a transaction which involves capital receipt. In one sense, it may be regarded as an error of law on merits because that authority has power over the individual involved and to determine whether the transaction in question amounts to "capital receipt" or "income". But, in another sense, it may be regarded as an error affecting jurisdiction of the authority to tax as it has power to tax only the income and not capital receipt. And therefore, taxing capital receipt may be treated as a case of the authority exceeding its power.

5. Procedural Defects

If an authority fails to observe a procedural requirement which is considered to be mandatory, then its decision is liable to be quashed on the ground of *ultra vires*. Whether disregard of procedure would vitiate administrative action or not depends upon whether the procedure is held to be directory or mandatory. Breach of directory procedure does not invalidate administrative action but breach of a mandatory provision would.

Supreme Court in *Sree Ayyanar Spinning & Weaving Mills Ltd. vs. CIT 301 ITR 434* held in the context of rectification powers u/s. 254(2) that the first part of section 254(2) refers to *suo motu* exercise of the power of rectification by the Tribunal whereas the second part refers to rectification and amendment on an application being made by the AO or the assessee pointing out the mistake apparent from the record. If the application for rectification was made within four years and the Tribunal which took its own time to dispose off the application, the Order of Rectification u/s. 254(2) would not be invalid. Similar view has been adopted in the context of Section 154(7) by Mumbai ITAT in case of *Desai Investments Pvt. Ltd. vs. ITO ITA No. 6447/Mum/2008.*

6. Specific Provisions under Income-tax Act

In the light of the above principles, some of the important provisions of Income Tax Act are discussed hereunder:

6.1 Notice u/s. 143(2)

Under the Income-tax act, the fundamental obligation arises to every person having taxable income, to declare his correct income by way of filing the return of income and pay taxes thereon. Underlying such obligations, there are different powers entrusted to the Authorities under the Act to ensure that the obligation is duly and correctly discharged. Amongst such powers, the power to make assessment u/s. 143(3) popularly understood as scrutiny assessment is one. During such proceedings, the Assessing Officer may verify the return of income after calling various details and make an assessment of income and determine the sum payable. This proceeding is initiated by serving a notice u/s. 143(2). To understand the implications of the notice u/s. 143(2), reference to the Section is made as under:

"143(2) -Where a return has been made under s. 139, or in response to a notice under sub-s. (1) of s. 142, the AO shall, if he considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

Provided that no notice under this sub-section shall be served on the assessee after the expiry of twelve months from the end of the month in which the return is furnished."

A perusal of the provisions of s. 143(2) of the Act shows that the service of the notice on the assessee within the period provided under the proviso is mandatory. In the absence of the notice being served within the stipulated period under s. 143(2) of the Act, the assessment proceeding comes to an end and is deemed to have become final. Proviso to s. 143(2) is in the nature of an embargo on the AO not to issue notice, if the period has expired. In other words, the AO is bound to accept the return as filed. Though the notice under s. 143(2) may be procedural, the proviso is not merely procedural but is in the nature of a limitation on the power of the AO not to proceed further in a case where return has been filed under s. 139.

CIT vs. M. Chellappan 281 ITR 444 (Mad.);

Vipan Khanna vs. CIT 255 ITR 220 (P&H);

CIT vs. C. Palaniappan 284 ITR 257 (Mad.);

CIT vs. Bhan Textiles (P) Ltd. 287 ITR 370 (Del.);

CIT vs. Lunar Diamonds Ltd. 281 ITR 1 (Del.) and

Dy. CIT vs. Mahi Valley Hotels & Resorts 287 ITR 360 (Guj.).

Section 143(2) is applicable to proceedings u/s. 147. In respect of returns filed pursuant to notice u/s. 148. It is mandatory to serve notice u/s. 143(2) within the stipulated time limit.

CWT v. HUF of H. H. Late J. M. Scindia 300 ITR 193 (Bom.);

CIT vs. Malvika Arun Somaiya 2 taxmann.com 144 (Bom.)

ACIT vs. Geno Pharmaceuticals Bom 32 taxmann.com 163

6.2 Service vs. Issue

The notice u/s. 143(2) is tested as jurisdictional requirement to be fulfilled within the specified time. The distinction about service and issue becomes relevant here. The provisions of the Section are to be strictly construed. Section uses the term "Shall Serve". A distinction with reference to "issue" and "service" is made by the Supreme Court in case of *R. K. Upadhyay vs. Shantabai B Patel 166 ITR 163* wherein the Supreme Court was dealing with the notice u/s. 148. Referring to the words used in the Section, the Scheme of the Act, Supreme Court held that the scheme of the 1961 Act so far as notice for reassessment is concerned is quite different. What used to be contained in s. 34 of the 1922 Act has been spread out into three sections, being ss. 147, 148 and 149, in the 1961 Act. A clear distinction has been made out between the "issue of notice" and "service of notice" under the 1961 Act. Sec. 149 prescribes the period of limitation. It categorically prescribes that no notice under s. 148 shall be issued after the prescribed limitation has lapsed. Sec. 148(1) provides for service of notice as a condition precedent to making the order of assessment. Once a notice is issued within the period of limitation, jurisdiction becomes vested in the ITO to proceed to reassess.

Going by the above interpretation and referring to Section 143(2), it is seen that Scheme of the Act for Section 143(2) requires service within the prescribed time and not mere issue.

As held in *CIT vs. Bhan Textiles (P) Ltd. 287 ITR 370 (Del);* notice under s. 143(2) must be served on the assessee within the prescribed time-limit; service of notice after the prescribed time-limit would not relate back to the date of issue of notice.

CIT vs. Vardhaman Estate Pvt. Ltd. 208 CTR 251 Del. held that date of dispatch of notice cannot be deemed to be the date of service; notice under s. 143(2) having been served on the assessee through speed post after the expiry of prescribed time-limit and there being no relevant document before the Tribunal to show that the same was served within the prescribed time through the process server, the service of notice was not effected in time.

Section 282 of the Income-tax Act regulates the service of notice by providing that a notice or requisition under the Income-tax Act may be served on the person named therein either by post or as if it were a summons issued by a Court under the Code of Civil Procedure. Onus is on the Department to prove that the service of notice had been validly made in accordance with law, and failure to discharge the onus would entitle the Appellant Authority or Court to presume that no valid service had been effected. *[Fateh Chand Agarwal vs. CWT (1974) 97 ITR 701 (Ori.)* and *Ram Parkash Kamlesh Kumar vs. CST (1976) Tax LR 1955 (All.)].* There is no presumption that the officer or authority had made valid service of notice as required by law because the presumption can only be raised if the act of service had been proved as having been done; but when the very act of service is being questioned, it cannot be presumed as having been performed. *[Rasiklal Amritlal Doshi vs. ITO (1961) 42 ITR 35 (Bom.).* For the constraints of space, the issues regarding proper service are not covered in the present discussion.

6.3 Jurisdiction of Assessing Officer

6.3.1 The subject of jurisdiction of the Assessing Officer in respect of any person has much relevance and importance in the present study. In law as well as practice, often one is faced with a situation where notices are issued by Officers who are not perceived as an Assessing Officers mainly on account of the facts that returns are not filed with them or they are not the Officers who assessed him earlier. Notices are issued mainly on account of the information from AIR Data with reference to the Bank accounts maintained or as per PAN Data. The issue becomes relevant in the context of validity of jurisdiction excercised by such Officer.

6.3.2 It may be useful to refer the statutory provision pertaining to the jurisdiction of ITOs. Chapter XIII of the Act deals with IT authorities. Part A of this chapter deals with the appointment and control of the various IT authorities including ITOs. Part B deals with the jurisdiction of the various authorities. Sec. 124 in this part outlines the jurisdiction of ITOs. (The provisions are not reproduced for constraints of space.) The above provisions have been well-explained by Delhi High Court in case of *Kanjimal & Sons vs. CIT 138 ITR 391.* An ITO will have jurisdiction over persons residing or having their principal place of business within the specified area. But complexities of modern economic life render this too simple a classification to be of practical utility – Jurisdiction is, therefore, assigned by the CITs on the basis of the other three criteria, which have what may be loosely described as "extra territorial" impact. Sub-s. (2) outlines the possibilities of these classifications overlapping and its later amendments envisage a concurrent exercise of jurisdiction by more than one designated officer, subject to general or special orders of higher authorities. Sec. 126 contemplates an allocation of jurisdiction among the ITOs by the Board. Sec. 127 confers powers of transfer on the CIT and the Board. These delineations of jurisdiction are done by innumerable orders issued from time-to-time at various levels and genuine difficulties may arise in many cases in sorting out which officer has jurisdiction over a particular assessee or class of assessees at a particular point of time. These difficulties highlight the necessity of having such problems sorted out at the earliest possible stage. Though the statute has safeguarded the position of the Revenue by reference to concurrent jurisdiction in more than one officer, the Act does not really contemplate a multi-pronged drive against the same assessee by several officers. That is why the procedure in sub-ss. (4) to (6) of Section 124 have been devised which gives the assessee a right to ensure that they are assessed by the proper officer, safeguards the Revenue at the same time by insisting that objections are raised at the earliest point of time practicable and leaves the decision in the hands of the CIT who is the person best equipped to decide the issue. The non-obstante clause at the beginning of sub-s. (7) is very wide and makes it clear that it is intended as a saving provision against the technical objections and disputes that may be raised in view of the other sub-sections.

6.3.3 Having set out elaborately in sub-ss. (1) to (6) of sec 124, the basis of the determination of jurisdiction of the officer and also having outlined a procedure whereby any disputes regarding jurisdiction can be sorted out, if raised in sufficient time, the, Act nevertheless provides a safety valve whereby the validity of assessments are protected notwithstanding an error in the exercise of jurisdiction in accordance with the earlier sub-sections if there has been no injustice to the assessee, and he has been assessed only by an officer who is having jurisdiction over the area in which the assessee resides or carries on the business and that too only in respect of income falling within the area covered by that jurisdiction.

6.3.4 It will be appreciated that this is a very limited saving clause. Question of jurisdiction cannot be made subject matter of appeal, as the issue has to be decided on the administrative side by the Commissioner/Commissioners/ Board. Appeal can, however, be filed questioning the action of the Assessing Officer in not following the procedure mentioned/ stipulated in Section 124. Delhi High Court in *Kanji Mal & Sons vs. CIT (1982) 138 ITR 391 (Del.),* it was observed that if the assessee fails to raise objection before the Income-tax Officer within the time, he will be shut out from raising the question altogether. Further, if the issue was raised and decided by the Commissioner, the decision would be final and cannot be questioned in the appellate forums but where the Income-tax Officer does not refer the question to the Commissioner, the failure should not be held to vitiate the assessment altogether and that it should be open to the appellate authority to set aside the assessment for being redone in accordance with law after having the matter referred to the CIT and obtaining his decision. Refer *Kapurchand Shrimal vs. CIT [1981]131 ITR45 1 SC.*

6.3.5 The above position would hold good when the authority does not lack or suffer from inherent lack of subject matter jurisdiction. When there is inherent lack of subject-matter jurisdiction, principle of waiver does not apply. The principle being simple that by consent one cannot confer jurisdiction on authority which lacks inherent subject matter jurisdiction. In *Budhia Swain and Ors. vs. Gopinath Dev and (1999) 4 SCC 396,* it was highlighted that distinction exists and was well-recognized between lack of jurisdiction and mere error in exercise of jurisdiction. Lack of jurisdiction strikes at the very root of the action/act and want of jurisdiction might vitiate proceedings rendering the orders passed and exercise thereof, a nullity.

Refer Patna High Court in *Mahalliram Ramniranjan Das vs. CIT (1985) 156 ITR 885, Supreme Court in Guduthur Bros. vs. ITO (1960) 40 ITR 298 (SC).*

The above legal position recently has been elaborately dealt by Delhi High Court in *Abhishek Jain vs. ITO 405 ITR 1 (Del.).*

6.4 Initiation of Penalty Proceedings

6.4.1 Penalties are imposed to restrain the assessee from making defaults under the Act and are considered as quasi-criminal proceedings. As laid down by the Supreme Court in the case of *Ananthram Veersinghaiah vs. CIT (123 ITR 457),* the penalty proceedings are separate and independent from penalty proceedings. The AO is required to consider the entire material on record in order to decide whether penalty is leviable or not. The assessee can also place any further evidence in support of his case to prove that there was no default on his part. The findings or observations made in assessment proceedings are relevant but not conclusive in penalty proceedings. In the context of concealment penalty u/s. 271(1)(c), the law requires before initiating the penalty proceedings, satisfaction to be recorded by Assessing Officer during the course of assessment proceedings. The term used in Section 271 'in the course of any proceedings under this Act is satisfied' cannotes the necessary condition for levy of concealment penalty. The AO should record his satisfaction that income has been concealed or inaccurate particulars of income have been furnished. Merely initiation of penalty proceedings would not mean that required satisfaction has been arrived at. The law regarding satisfaction was laid down in various decisions stated below-

D. M. Manaswi vs. CIT 86 ITR 557 SC

CIT vs. Ram Commercial Enterprises 246 ITR 568 Del.

Diwan Enterprises vs. CIT 246 ITR 571 Del.

6.4.2 There was an amendment to Section 271 whereby sub-section (1B) was introduced by Finance Act 2008 wref 1-4-1989 which provided that 'Where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under clause (c) of sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of penalty proceedings under the said clause (c).

6.4.3 The above amendment has been explained by Delhi High Court in the case of *Madhushree Gupta vs. UOI 317 ITR 107* and held that the recording of a satisfaction is a jurisdictional condition which is not wished away after amendment. The sub-section 1B purely means that the order initiating penalty cannot be held to be bad in law merely because it says that the penalty proceedings are initiated. However it must still be discernible from the record that the AO has arrived at *prima facie* satisfaction for initiating penalty proceedings. The position is no different post-amendment. Sec. 271(1)(c) has to be read in consonance of s. 271(1B). The presence of *prima facie* satisfaction for initiation of penalty proceedings was and remains a jurisdictional fact which cannot be wished away as the provision stands even today, i.e., post-amendment. The AO would not be in a position to pick a case for initiation of penalty merely because there is an addition or disallowance without arriving at a *prima facie* satisfaction with respect to infraction by the assessee of cl. (c) of sub-s. (1) of s. 271 – a requirement which is mandated by the provision itself. Refer observations in *CIT vs. Rampur Engineering Co. Ltd. 309 ITR 143 (Del)(FB).*

6.5 Specific Charge

6.5.1 The condition of satisfaction is further extended to the specific charge of penalty. The charge for levy of penalty u/s. 271(1)(c) is concealing the particulars of income or furnishing inaccurate particulars of income. Karnataka High Court in *CIT vs. Manjunath Cotton and Ginning Factory 359 ITR 565* held:

"The Assessing Officer is empowered under the Act to initiate penalty proceedings once he is satisfied in the course of any proceedings that there is concealment of income or furnishing of inaccurate particulars of total income under clause (c). Concealment, furnishing inaccurate particulars of income are different. Thus, the Assessing Officer while issuing notice has to come to the conclusion that whether it is a case of concealment of income or it is a case of furnishing of inaccurate particulars. The principle has been affirmed by Apex Court in the case of *Ashok Pai reported in [2007] 292 ITR 11 (SC)* at page 19. The Gujarat High Court in the case of Manu Engineering reported in 122 ITR 306 and the Delhi High Court in the case of *Virgo Marketing P. Ltd., reported in 171 Taxmann 156.*

Bombay High Court in *CIT vs. Samson Perichery 98 CCH 444* held in the face of the decision of the Supreme Court in *Ashok Pai vs. CIT 292 ITR 11 [relied upon in Manjunath Cotton & Ginning Factory (supra)]* - wherein it is observed that concealment of income and furnishing of inaccurate particulars of income in Section 271(1)(c) of the Act, carry different meanings/ connotations. Therefore, the satisfaction of the Assessing Officer with regard to only one of the two breaches mentioned under Section 271(1)(c) of the Act, for initiation of penalty proceedings will not warrant / permit penalty being imposed for the other breach. This is more so, as an assessee would respond to the ground on which the penalty has been initiated/ notice issued. It must, therefore, follow that the order imposing penalty has to be made only on the ground of which the penalty proceedings has been initiated, and it cannot be on a fresh ground of which the assessee has no notice.

Bombay High Court *CIT vs. Tata Consultancy Ltd 374 ITR 112*

Supreme Court in case of *Jai Laxmi Rice Mills reported in 379 ITR 521* reaffirmed the above principle in the context of penalty u/s. 271E.

6.6 New Penalty u/s. 270A

6.6.1 The new penalty u/s. 270A uses the Expression "Under Reporting". Sub-section (2) provides that a person shall be considered to have under reported his income. In spite of the conspicuous absence of the term 'ís satisfied' in Section 270A, the words appearing in the new Section – "may direct any person who has under-reported his income shall be liable to a penalty"- imply the inherent principle of Penalty Proceedings. The wordings are similar to one used in Section 158BFA(2) which the Courts have interpreted u/s. 158BFA keeping in mind the quasi-criminal nature. The word "may" therefore was interpreted to say that the officer has the discretion to levy the penalty depending on the facts and circumstances of the case. The word 'may' gets crucial to perceive the proceedings with the inbuilt judicious discretion to be adopted by the officer while initiating the penalty. Sub-Section (2) using the term 'considered to have under-reported' suggests application of mind before charging a person for under-reporting.

6.7 292BB – A Rule of Evidence

6.7.1 Section 292BB provides that where an assessee has appeared in any proceedings or co-operated in any inquiry relating to an assessment or reassessment, it shall be deemed that any notice under any provision of this Act, which is required to be served upon him, has been duly served upon him in time in accordance with the provisions of this Act and such assessee shall be precluded from taking any objection in any proceeding or inquiry under the Act that the notice was not served upon him or not served upon him in time or served upon him in an improper manner. Sec. 292BB is a rule of evidence, which validates the notice in certain circumstances. A careful reading of sec 292BB suggests that the provisions make a presumption or creates a fiction purely of 'service of notice' and operates only in respect of service of notice and that to only in specific situations specified therein. The scope of the Section is interpreted to be restricted and not to be enlarged so as to create any estoppel against the jurisdictional conditions.

6.7.2 In the context of notice u/s. 143(2) Courts have taken a view that provisions of section 292BB are applicable where there is a failure to serve the notice and not where there is a failure to issue the notice under section 143(2) and the said defect was not curable under section 292BB. Refer Allahabad High Court in the case of *Asstt. CIT vs. Greater Noida Industrial Development Authority 379 ITR 14*, Delhi High Court in the case of *Pr. CIT vs. Shri Jay Shiv Shankar Traders (P.) Ltd. (2016) 383 ITR*, Kerala High Court in the case of *Travancore Diagnostic (P.) Ltd. vs. Dy. CIT (2017) 390 ITR 167.*

Delhi Tribunal in the case of *ITO vs. Naseman Farms P. Ltd. reported in 134 TTJ 472* in which case the notice u/s. 148 was issued by an AO who was not having jurisdiction over the assessee and the Tribunal observed and commented on the provisions of section 292BB that the provisions will not apply where the defect in the notice is of a jurisdictional defect like in the case before them and held that the defect was such that it goes to the root of the proceedings and is a jurisdictional defect and therefore cannot come within the ambit of section 292BB.

Madras High Court in case of *CIT vs. M. Hemanathan 384 ITR 177* dealt with a facts where notice was first issued in the name of dead person. While deciding the validity of the notice as also the proceedings, it has explained the purpose and held that Section 292BB is in place to take care of contingencies where an assessee is put on notice of the initiation of proceedings, but who takes advantage of defective notices or defective service of notice on him. It is trite to point out that the purpose of issue of notice is to make the noticee aware of the nature of the proceedings. Once the nature of the proceedings is made known and understood by the assessee, he should not be allowed to take advantage of certain procedural defects. That was the purpose behind the enactment of Section 292BB. It cannot be invoked in cases where the very initiation of proceedings is against a dead person.

In view of the above discussion and the judicial precedents, the validity of jurisdictional condition going to the root of the matter does not get lifted by Section 292BB.

6.8 Principles of Natural Justice

6.8.1 *Concept*

'Natural justice' is about fair play in action or duty to act fairly to a situation. Justice is a very elaborate conception, the growth of many centuries of civilisation. Earlier, the concept of natural justice was conceived to mean that there is nothing natural about natural justice because lion will eat lamb and therefore natural justice is that the strong will destroy the weak. Therefrom the concept of fairness or justice that we have now, is in a way artificial concept which is a result of civilisation and it is not something inborn. Justice is an elaborate, artificial concept, certainly not natural, in the sense the society gives rise to principles of justice. But over a period of years, these principles have now acquired some meaning. These principles permeate everywhere whether it is quasi-judicial, administrative so long as there are consequences hostile to the person. Obviously, Income-tax Act would encompass with equal spirit and force.

6.8.2 *Principles*

The Principles have now been developed. Originally two and now three principles as under:

Audi Alteram Partem – No man should be condemned before giving him hearing. The important elements of this principle are that there must be fair and due notice to reply to the charges and second is that the person must have an adequate and effective opportunity of rebutting the material which is sought to be relied upon against. If the Department wants to rely upon account books of any connected concern or any other material, it is incumbent upon the department to disclose them and to give an opportunity to the party to have a say. The right of Cross Examination is one of the most effective means by which truth can be discovered. So if a statement of a person is relied upon, he must be produced to be cross-examined. This right of cross-examination must be allowed to the most possible extent unless it is beyond possibility. Supreme Court in case of *CIT vs. Sunita Dhadda* recently dismissed SLP of the Department wherein it was held that if the AO wants to rely upon documents found with third parties, the presumption u/s. 292C against the assessee is not available. As per the principles of natural justice, the AO has to provide the evidence to the assessee & grant opportunity of cross-examination. Secondary evidences cannot be relied on as if neither the person who prepared the documents nor the witnesses are produced. The violation of natural justice renders the assessment void. The Department cannot be given a second chance. The law on violation of natural justice thus has been reaffirmed by referring to earlier judgments.

Nemo Judex Indiswa – No man should be a judge in his own cause. *Concept of Bias. Impartial Justice.* A judge must have no interest in a case, in which he has to give a decision. The interest may be pecuniary, official, relationship with a person or any close connection with the party. This becomes a very important principle in the administration of justice so to further the end cause that justice must not only be done but manifestly seen to be done.

Speaking Order – The Order must be reasoned Order and must speak. All Orders that affect the citizens must have reasons for that. The broad reasons behind this are one – Judge is forced to scrutinise the matter, give reasons and put up certain principle for decision. This compels the judge to act without arbitrariness. Second – the Appellate Authority must know the reason or basis on which such decision has been rendered. Third – the decisions are subject to Writ jurisdictions of higher courts. The higher court must know why a certain reason was given.

6.8.3 *Breach/Violation of Principles of Natural Justice*

A question arises as to whether these principles are rigid or flexible. Violation or breach of natural justice is looked upon as resulting into nullity of the action. The question therefore whether the matter should be remanded back loses significance with the principle that the action does not survive and the Department may initiate new proceedings within the available limitation of the Statute. The opportunity denied may not be made good by providing the same at the higher forum. This is in accordance with the strict interpretation of the principle of natural justice that a person is entitled for opportunity at all forums and they are not substituted for one another.

Though the principles are rigid enough so as to be followed to its fullest extent, there are exceptions. If the law itself provides that no opportunity will be given for the order to be passed, then one may challenge the law but not on the principles of natural justice. It means principles of natural justice may supplement the law but do not supplant the law. Further in case of emergency, the principle of opportunity may be abandoned or even postponed. If a person is going away from India and absconding, his passport has to be seized. In such situation opportunity cannot be given so as to allow him to run. Howsoever, in most of the cases where opportunity cannot be given before action, it must be given at the earliest. It may depend on facts and situation in each case.

So is the case of cross-examination. Often classic facts referred about when boys in a hostel are charged for teasing girls on the basis of complaint made by the girls. On boys asking for cross-examination, the Court did deny such cross-examination so as not to expose the girls. In such circumstances Courts may waive the principles. The principles of natural justice therefore may be ever evolving as per the changing values and habits of the civil societies.

6.8.4 *Waiver*

A person may waive his right to be heard by expressly agreeing that no hearing is necessary and that the authority may decide without a hearing. Similarly, the requirement of granting opportunity is met if in spite of an adequate notice by the authority to him to present his case, he does not come forward to take advantage of the opportunity.

In granting relief on account of failure of natural justice, the Courts have taken recourse of pragmatism rather than acting mechanically. The principles may be looked upon to the changing times and values and a pinch of caution would be desired as to defend the situation solely and purely on the basis of principles of natural justice.

7. Conclusion

As per the traditional approach there exists a fine distinction between "Jurisdictional Error" and "Error of Law". That it is not easy to maintain a distinction between mistake of law pure and simple, and mistake of law going to the root of the jurisdiction of the body concerned. It may be a case that on a wrong interpretation of the provisions of the Act, the authority has exercised jurisdiction in respect of a subject-matter which on a correct interpretation he does not possess. In a sense he acts without jurisdiction. It can also be looked upon as that the quasi-judicial authority has jurisdiction to decide a matter, it does not lose its jurisdiction by coming to a wrong conclusion. The distinction may be of little importance with the mandate of the statutory provisions and effective remedies available.

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> No man is to be judged by the mere nature of his duties, but all should be judged by the manner and the spirit in which they perform them.
>
> — *Swami Vivekananda*

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Utkarsh Bhatnagar & Harsh Kumar, *Advocates*

HOT SPOT

Proposed Amendments to The Indian Stamp Act, 1899

A. Introduction

The (Indian) Central Government tabled the Finance Bill, 2019 ("Bill") before the Lok Sabha to propose certain amendments in: (a) the rates of Income Tax, (b) the Indian Stamp Act, 1899 ("Stamp Act"), and (c) Prevention of Money Laundering Act, 2002. The amendments to the Stamp Act have been proposed to streamline stamp duty payments on financial securities transaction in India. The Bill was passed by both the houses of Parliament, on February 12 and 13, 2019 and received the Presidential assent on February 21, 2019, whereby making it a Finance Act, 2019 ("Finance Act"). However, per Section 11 of the Finance Act, the proposed amendments in the Stamp Act will only come into force on such date as appointed by the Central Government *vide* notification in the Official Gazette.

This article provides a high-level snapshot of the key amendments proposed under the Finance Act to the Stamp Act. The Finance Act, will impact transactions that attract payment of stamp duty by Indian companies (both listed and unlisted). Further, the procedure for implementation of certain provisions, for example, the mechanism for collection of tax by stock exchanges/clearing exchange/depositories and its transfer to the State Government may also be subject to the requisite rules passed by the Central Government in this regard.

B. Key changes in the Stamp Act

The key changes proposed to the Stamp Act *vide* the Finance Act, and which are relevant from a securities transactional perspective are set out below:

1. Modification/expansion of existing definitions

(a) **Instrument** – The scope of expression 'instrument' has been expanded to include any documents (electronic or otherwise) created for a transaction undertaken through a stock exchange or depository, and by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded. Hitherto, applicability of stamp duty to electronic documents was not specifically covered under the Stamp Act. Accordingly, this modification is a welcome clarification.

(b) **Market Value** – The definition of market value has been clarified for both listed and unlisted instruments/ securities. The market value of: (i) a security traded on a stock exchange will mean the trading price of such security, and (ii) an unlisted security will mean the price or the consideration mentioned in such instrument/security and regardless of whether the security is transferred through a depository or by delivery.

2. Stamp duty on transaction instead of instrument

The Finance Act proposes that in case of issue, sale or transfer of securities, the stamp duty will be payable only on the principal instrument. Accordingly, no additional stamp-duty is chargeable on any other instrument relating to the same transaction. This change is likely to simplify the process for payment of stamp duty, as only principal documents will need to be stamped. All ancillary documents that form part of the same transaction will not be subject to separate/ additional stamp duty payments.

3. Centralised collection of stamp duty

The Finance Act requires the collection of stamp duty by a depository/stock exchange/ clearing corporation, as the case may be and its transfer to the State Government within 3 (three) weeks from end of each calendar month. The transfer is required to be made to the relevant State Government where the residence/registered office of the buyer is located, failing which, first to the State Government where the registered office of the trading member/broker of the buyer is located and thereafter to the State Government where the registered office of the participant is located. Any failure by the depository/stock exchange/clearing corporation in compliance with the aforesaid obligations may attract monetary penalty of at least INR 1,00,000 (Indian Rupees One Lakh only) and which may extend up to 1% (one per cent) of the amount required to be collected.

4. Sale of dematerialised securities

(a) Sale of listed dematerialised securities will be subject to stamp duty. If the listed dematerialised securities are: (i) debentures, then the stamp duty will be payable at the rate of 0.0001% of the trading price of the debentures, or (ii) securities other than debentures, then transfer: (A) on delivery basis will attract stamp duty at the rate of 0.015% of the market value of such security, and (B) on non-delivery basis will attract stamp duty at the rate of 0.003% of the market value of such security.

(b) Transfer of dematerialised securities was previously exempted from stamp duty. However, securities transaction tax ("STT") was applicable to listed securities transferred through a stock exchange. Therefore, the proposed additional stamp duty cost will have to be factored-in by buyers as part of exit from a company having dematerialised securities. Further, transfer of all listed dematerialised securities will attract both stamp duty and STT.

5. Issue of securities

The Finance Act prescribes a uniform rate of stamp duty on issuance of listed/unlisted securities whether in dematerialised or in a physical form. Stamp duty will be calculated on an ad-valorem basis linked to: (i) actual trading price for listed securities, or (ii) price identified in the instrument of issue.

The Finance Act clarifies that stamp duty payable by the issuer otherwise than through a stock exchange or depository, will be determined as per the location of registered office of the company and not as per the place of the board meeting that approved the issuance of new securities. Accordingly, this clarification will prevent forum shopping by companies for Indian states that offer favourable stamp duty rates. However, stamp duty on issue of share is within the jurisdiction of State. Hence, there may be uncertainty as to applicability of amended provision vis-à-vis provisions of state specific stamp acts.

6. Waiver on transfer of securities and mutual fund units in a dematerialised form

The Finance Act exempts applicability of stamp duty on transfer of: (i) registered ownership of securities from a person to a depository, or (ii) transfer of registered ownership by a depository to the beneficial owner. This amendment shall exempt transactions involving the transfer of registered ownership in case of depository receipts. However amendment has deleted the waivers provided in respect to transfer of beneficial ownership of securities, units of mutual fund (including units of the Unit Trust of India) units which are dealt with by a depository.

7. Conclusion

The proposed rationalised and harmonised system once notified is expected to minimalise the tax evasion and cost of collection while enhancing revenue productivity. The proposed system will also assist the development of equity markets and equity culture on a pan-India basis, resulting in ushering balanced regional development.

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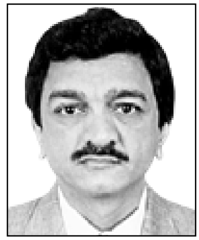
Don't look back – forward, infinite energy, infinite enthusiasm, infinite daring and infinite patience — then alone can great deeds be accomplished.

— *Swami Vivekananda*

Fill the brain with high thoughts, highest ideals, place them day and night before you, and out of that will come great work.

— *Swami Vivekananda*



B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Merely because the assessee company had filed all primary evidence, it could not be said that onus on assessee to establish credit worthiness of investor companies stood discharged

Principal Commissioner of Income-tax vs. NRA Iron & Steel (P.) Ltd. [(2019) 103 taxmann.com 48 (SC)]

1. For A.Y. 2009-10, the assessee company had filed its return on 29th September, 2009 declaring total income of ₹ 7,01,870/-. The said assessment was reopened by issuing notice u/s. 148 of the I.T. Act, 1961 on 13th April, 2012. The objections against issuance of notice u/s. 148 were rejected by the AO.

2. During the year under consideration, the assessee company had received share capital and premium thereon aggregating to ₹ 17,60,00,000/- from 19 different companies. The AO, in the course of the assessment proceedings, independently got field enquiries conducted with respect to identity and creditworthiness of investor companies and to examine the genuineness of the transaction. The result of the said enquiry is summarised as under:

S. No	Name of Investor Company	Remarks
1.	Clifton Securities Pvt. Ltd., Mumbai	Notice served – but no reply received.
2.	Lexus Infotech Ltd., Mumbai	Notice served – but no reply received.
3.	Nicco Securities Pvt. Ltd., Mumbai	Notice served – but no reply received.
4.	Real Gold Trading Co. Pvt. Ltd., Mumbai	Address incorrect – office found closed bearing the name of other company.
5.	Hema Trading Co. Pvt. Ltd., Mumbai	Notice not served – Premises is owned by some other person.
6.	Eternity Multi Trade Pvt. Ltd., Mumbai	Notice not served – Premises is owned by some other person.

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S. No	Name of Investor Company	Remarks
7.	Neha Cassettes Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. The Company had shown total income of ₹ 9,744/- in A.Y. 2009-10.
8.	Warner Multimedia Ltd. Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown ₹ NIL income for A.Y. 2009-10.
9.	Gopikar Supply Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 28,387/- in A.Y. 2009-10.
10.	Ganga Builders Ltd., Kolkata	Reply filed accepting the subscription of shares but it had not specified how many shares and at what premium they had purchased – Company had shown income of ₹ 5,850/- in A.Y. 2009-10.
11.	Gromore Fund Management Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 14,130/- in A.Y. 2009-10.
12.	Bayanwala Brothers Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 10,626/- in A.Y. 2009-10.
13.	Super Finance Ltd., Kolkata	Reply filed accepting the subscription of shares but it had not specified how many shares and at what premium they had purchased – Company had shown income of ₹ 10,730/- in A.Y. 2009-10.
14.	Shivlaxmi Export Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 10,480/- in A.Y. 2009-10.
15.	Natraj Vinimay Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 42,083/- in A.Y. 2009-10.
16..	Neelkanth Commodities Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 9,470/- in A.Y. 2009-10.
17.	Prominent Vyappar Pvt. Ltd., Kolkata	Reply filed accepting the subscription of shares at premium but not given any reason for paying such a high premium. – Company had shown income of ₹ 10,307/- in A.Y. 2009-10.

3. The AO also recorded that out of four companies at Mumbai, two companies were found to be non-existent at the address furnished. The AO further observed that in respect of Kolkata companies, nobody appeared, nor did they produce their bank statements to substantiate the

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source of the funds. In respect of two Guwahati companies, enquiries revealed that they were non-existent at the given address.

4. The Commissioner (Appeals) deleted the addition made by the AO. The Revenue's appeal before the Appellate Tribunal was dismissed on the ground that the assessee had discharged the primary onus to establish the identity and creditworthiness of the investor establishing that the investor companies had filed their returns and were being assessed.

5. The High Court dismissed the appeal filed by the Revenue and affirmed the decision of the Tribunal on the ground that no substantial question of law arose.

6. Before the Supreme Court, the Respondent Company did not remain present and therefore, the appeal of the Revenue was heard *ex-parte*.

7. The Supreme Court reversed the judgment of the High Court, the Appellate Tribunal and the Commissioner (Appeals) and restored the order of the AO. On the issue of unexplained credit entries, the Supreme Court examined the judgments in the case of *Sumati Dayal vs. CIT (214 ITR 801), CIT vs. P. Mohankala (291 ITR 278), Pr.CIT vs. NDR Promoters Pvt. Ltd. (410 ITR 379, Del.), Roshan Di Hatti vs. CIT (2 SCC 378), CIT vs. N. R. Portfolio (P.) Ltd. (42 taxmann.com 339) and CIT vs. Value Capital Service (P.) Ltd. (307 ITR 334).*

8. Thereafter, the Supreme Court held as under:

> **"9.** The Judgments cited hold that the Assessing Officer ought to conduct an independent enquiry to verify the genuineness of the credit entries.
>
> "In the present case, the Assessing Officer made an independent and detailed enquiry, including survey of the so-called investor companies from Mumbai, Kolkata and Guwahati to verify the credit-worthiness of the parties, the source of funds invested, and the genuineness of the transactions. The field reports revealed that the shareholders were either non-existent, or lacked credit-worthiness."

"11. The principles which emerge where sums of money are credited as share capital/premium are:

"i. The assessee is under a legal obligation to prove the genuineness of the transaction, the identity of the creditors, and credit-worthiness of the investors who should have the financial capacity to make the investment in question, to the satisfaction of the AO, so as to discharge the primary onus.

"ii. The Assessing Officer is duty bound to investigate the credit-worthiness of the creditor/subscriber, verify the identity of the subscribers, and ascertain whether the transaction is genuine, or these are bogus entries of name-lenders.

"iii. If the enquiries and investigations reveal that the identity of the creditors to be dubious or doubtful, or lack credit-worthiness, then the genuineness of the transaction would not be established."

"In such a case, the assessee would not have discharged the primary onus contemplated by Section 68 of the Act."

"12. In the present case, the AO had conducted detailed enquiry which revealed that:

"i. There was no material on record to prove, or even remotely suggest, that the share application money was received from independent legal entities. The survey revealed that some of the investor companies

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were non-existent, and had no office at the address mentioned by the assessee.

For example:

"a. The companies Hema Trading Co. Pvt. Ltd. and Eternity Multi Trade Pvt. Ltd. at Mumbai, were found to be non-existent at the address given, and the premises was owned by some other person.

"b. The companies at Kolkata did not appear before the AO, nor did they produce their bank statements to substantiate the source of the funds from which the alleged investments were made.

"c. The two companies at Guwahati viz., Ispat Sheet Ltd. and Novelty Traders Ltd., were found to be non-existent at the address provided.

The genuineness of the transaction was found to be completely doubtful.

"ii. The enquiries revealed that the investor companies had filed returns for a negligible taxable income, which would show that the investors did not have the financial capacity to invest funds ranging between ₹ 90,00,000 to ₹ 95,00,000 in the Assessment Year 2009-10, for purchase of shares at such a high premium."

For example:

Neha Cassettes Pvt. Ltd. - Kolkata had disclosed a taxable income of ₹ 9,744/- for A.Y. 2009-10, but had purchased shares worth ₹ 90,00,000 in the assessee company.

Similarly Warner Multimedia Ltd. – Kolkata filed a NIL return, but had purchased shares worth ₹ 95,00,000 in the assessee company – Respondent.

Another example is of Ganga Builders Ltd. – Kolkata which had filed a return for ₹ 5,850 but invested in shares to the tune of ₹ 90,00,000 in the assessee company – Respondent, etc.

"iii. There was no explanation whatsoever offered as to why the investor companies had applied for shares of the assessee company at a high premium of ₹ 190 per share, even though the face value of the share was ₹ 10/- per share.

"iv. Furthermore, none of the so-called investor companies established the source of funds from which the high share premium was invested.

"v. The mere mention of the income tax file number of an investor was not sufficient to discharge the onus under Section 68 of the Act."

"**13.** The lower appellate authorities appear to have ignored the detailed findings of the AO from the field enquiry and investigations carried out by his office. The authorities below have erroneously held that merely because the Respondent Company – Assessee had filed all the primary evidence, the onus on the assessee stood discharged."

"The lower appellate authorities failed to appreciate that the investor companies which had filed income tax returns with a meagre or nil income had to explain how they had invested such huge sums of money in the assessee company – Respondent. Clearly the onus to establish the credit worthiness of the investor companies was not discharged. The entire transaction seemed bogus, and lacked credibility."

"The Court/Authorities below did not even advert to the field enquiry conducted by the AO which revealed that in several cases the investor companies were found to be non-existent, and the onus to establish the identity of the investor companies, was not discharged by the assessee."

"14. The practice of conversion of un-accounted money through the cloak of share capital/premium must be subject to careful scrutiny. This would be particularly so in the case of private placement of shares, where a higher onus is required to be placed on the assessee since the information is within the personal knowledge of the assessee. The assessee is under a legal obligation to prove the receipt of share capital/ premium to the satisfaction of the AO, failure of which, would justify addition of the said amount to the income of the assessee."

"15. On the facts of the present case, clearly the assessee company – Respondent failed to discharge the onus required u/s. 68 of the Act, the Assessing Officer was justified in adding back the amounts to the assessee's income."

SLP dismissed against High Court ruling that where assessee sold a piece of land on which it was running a nursery, in view of fact that land was declared as agricultural land in revenue records and, moreover, its distance from nearest municipality was beyond 8 kms., income arising from sale of said land could not be brought to tax

Principal Commissioner of Income-tax vs. P. S. Raghupathy [2019] 102 taxmann.com 223 (SC)

In A.Y. 2007-08, the assessee sold a piece of land and did not declare any income from the sale of the said land as it was agricultural land. The AO rejected the claim on the ground that the assessee could not establish that the land was agricultural land and could not submit books of account and supporting documents such as bills, and vouchers towards agricultural activities. However, the Tribunal noted that Land Revenue records clearly showed that the land was agricultural land. Secondly, the distance from the nearest municipality was also shown to be beyond 8 kms. Relying on the jurisdictional High Court judgment, the Tribunal held that the assessee was running a nursery on the said land which is held to be having agricultural operation.

The High Court dismissed the appeal of the Revenue as no substantial question of law arose from the Tribunal's order.

The Special Leave Petition against the order of the Madras High Court reported in 96 taxmann. com 200 was dismissed.

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The easiest way to make ourselves happy is to see that others are happy.

— Swami Vivekananda

Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES

High Court

1. Bogus Transactions – Assessee engaged in the trading business of commodities in National Multi-Commodity Exchange – incurred loss on off-market transactions – AO found that broker had been expelled for having involved in issuing forged and fraudulent contract notes – AO disallowed the loss treating the transactions as bogus – Tribunal allowed the loss – High Court dismissed the Departmental appeal

Pr. CIT vs. BLB Cables and Conductors Pvt. Ltd. [ITAT No.78 of 2017, GA No.747 of 2017, order dt.19-06-2018, Calcutta High Court]

Assessee, a Private Limited Company was engaged in the business of granting of loans and dealing in commodities. During the year assessee was engaged in the trading business of commodities in National Multi Commodity Exchange (NMCE). Assessee used the services of the broker namely, Vatika Merchant Pvt. Ltd., for the trading in the NMC exchange. The assessee had claimed a loss of ₹ 2,26,96,157/- in the business of trading in commodities. The AO during the course of assessment proceedings made enquiry from the NMCE to establish the genuineness of the above loss but found that the above said broker was expelled by the NMCE for having involved in issuing forged and fraudulent contract notes. In reply to the show cause notice, assessee submitted that all these transactions are off market transaction so not passed through the commodity exchange. The assessee also submitted all the purchase and sale contracts notes before AO in support of its claim. However, AO disregarded the claim of assessee by treating the transactions as bogus. Accordingly the AO disallowed the same and added it to the total income of assessee. Aggrieved, assessee preferred an appeal before learned CIT(A) where the assessee submitted that the broker has issued contract notes that for the purchase and sales before the AO. Beside the assessee submitted that all the payments were made by cheques on the basis of these contract notes. There was no need to intimate to the stock exchange as these transactions were made off the market. All the transactions were duly confirmed by the broker and

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were supported with bank statements and ledger copy of the account. The learned AR also pointed out that the assessee was never confronted with the confirmation submitted by the broker, so the order passed by the AO is without providing the opportunity of being heard. However the CIT(A) disregarded the plea of the assessee and upheld the order of the AO. The Tribunal observed that all transactions through the broker were duly recorded in the books of the assessee. The Tribunal held that there has to be some concrete evidence where the transactions cannot be proved with the supportive evidence. Here in the case the transactions of the commodity exchanged have not only been explained but also substantiated from the confirmation of the party. Both the parties are confirming the transactions which have been duly supported with the books of account and bank transactions. The broker was expelled from the commodity exchange cannot be the criteria to hold the transaction as bogus. The Tribunal thus reversed the order of the lower authorities and allowed assessee's appeal. On further appeal by the Department, High Court observed that no material has been shown which would negate the Tribunal's finding that off market transactions are not prohibited. As regards veracity of the transactions, the Tribunal came to its conclusion on analysis of relevant materials. That being the position, Tribunal having analysed the set of facts in coming to its finding, the High Court did not interfere with the order of the Tribunal stating that no substantial question of law arose in the appeal.

2. Reopening – Notice u/s. 148 challenged after receipt of recorded reasons without any objections being filed before the AO – Petition withdrawn – objections filed left AO with little time to dispose off the objections and thereafter complete the assessment before it becomes time barred – Subsequent challenge not entertained

Cenveo Publisher Services India Ltd. vs. UOI [WP 284 of 2019, order dt. 1-2-2019, Bombay High Court]

For AY 2011-12, assessee company had filed the return of income declaring the total income of ₹ 1.65 crore (rounded off). Subsequently assessee revised the return declaring the revised income of ₹ 2.64 crore (rounded off). The return of the petitioner was taken in scrutiny by the Assessing Officer who passed the order under Section 143(3) of the Income-tax Act, 1961 on 3-3-2015 accepting the petitioner's revised income. The AO reopened the assessment. In response to the notice of reopening of the assessment, the Petitioner filed return in April 2018 stating that the revised return may be treated as the return in response to the notice. In such a communication the Petitioner had also asked the Assessing Officer to supply the reasons recorded for reopening the assessment. Such reasons were supplied by the Assessing Officer to the Petitioner on 14-9-2018. Thereafter assessee filed a Writ Petition challenging the notice of reopening the assessment. The writ petition was taken up for hearing by the Court on 13th December, 2018. This Court noticed that the Petitioner had approached the Court without raising objections before the Assessing Officer. As this was clearly in breach of the mechanism devised by the Supreme Court in the case of *GKN Driveshafts (India) Ltd. vs. Income Tax Officer reported in 259 ITR 19 (SC)*, assessee withdrew the petition. The assessee thereafter raised objections before the Assessing Officer on 14-12-2018. Such objections were disposed off by the Assessing Officer on

28-12-2018. Since the last date for framing the assessment was fast approaching and the assessment would get time barred on 31st December, 2018, the Assessing Officer passed the order of assessment on 28-12-2018. The Assessing officer once again approached the Court challenging very notice of reopening of the assessment and the order of re-assessment as consequential to the main challenge to reopening of the assessment. It was argued that the notice of reopening of the assessment is based on the reasons which are not sustainable. He submitted that the impugned notice has been issued beyond the period of four years from the end of relevant assessment year without there being any failure on the part of the assessee to disclose truly all material facts. Thus the Assessing Officer does not have jurisdiction to reopen the assessment. It was further submitted that the Assessing Officer consumed considerably long time in providing the reasons for reopening the assessment and therefore notice could not have been challenged earlier. It was further pleaded that assessee should not be penalised for delay on the part of the Assessing Officer in supplying the reasons. The Court however dismissed the petition on the ground that assessee after being supplied the reasons for reopening of the assessment by the Assessing Officer on 14-9-2018, approached the Court by filing the Writ Petition in November, 2018, without first raising the objections before the Assessing Officer. This was in clear breach of the procedure laid down by Supreme Court in the case of GKN Driveshafts (supra). It is true that in a given case the mechanism provided by the Supreme Court in the case of GKN Driveshafts may be open to flexibility. However, the assessee cannot without any reason or explanation, at his will choose to file the Writ Petition directly before the Court without following the procedure set out in GKN Driveshafts (supra) i.e., without first raising the objections before the Assessing Officer. The Court held that allowing the assessee to do so without any explanation at all would dismantle such mechanism. For this very reason assessee withdrew its previous petition on 13th December, 2018 and filed the objections before the Assessing Officer. Though that assessee raised objections promptly after withdrawing the petition, it would not in any manner dilute the fact that it was on the ground of the petitioner's conduct that the Assessing Officer was left with little time to dispose off his objections and thereafter complete the assessment before it becomes time barred. The Court observed that as per the decision of *Asian Paints Ltd. vs. Dy. Comm. of Income Tax & Ors. 296 ITR 90 (Bom.)* if the Assessing Officer does not accept the objections of the assessee, he shall not proceed further in the matter within a period of four weeks from the date of receipt of said order of objections. It was held that the assessee by its conduct destroyed this formula provided by the Court in the case of Asian Paints, making it impossible for the assessing officer to wait for four weeks after disposal of objections without running the risk of allowing the assessment to be time barred. The Court by the self-imposed restriction, refused to entertain the petition.

3. Stay of demand – Though assessee may not have specifically invoked the three parameters for grant of stay, it is incumbent upon assessing officer to examine them and pass order accepting or rejecting stay application.

Mrs. Kannammal vs. ITO [WP 3849 of 2019, WMP 4278 of 2019, order dt.13-2-2019, Madras High Court]

Assessee filed income tax return of ₹ 6,23,770/- claiming an exemption in respect of ₹ 10,19,74,341/-. The exemption was denied by the AO and thus the total income computed was at ₹ 10,26,01,710/- which was several times in excess of the returned income. Assessee filed an appeal before the CIT(A) which was pending to be heard. Assessee further applied for stay of demand before the AO on 19-1-2019. However the stay demand was rejected on 25-1-2019 and assessee was called upon to pay the demand immediately. The Court observed that the parameters to be taken into account in considering the grant of stay of disputed demand are well-settled. They are 1) existence of a *prima facie* case, 2) financial stringency and 3) the balance of convenience. 'Financial stringency' would include within its ambit the question of 'irreparable injury' and 'undue hardship' as well. It is only upon an application of the three factors as aforesaid that the assessing officer can exercise discretion for the grant or rejection, wholly or in part, of a request for stay of disputed demand. The Court placed reliance on Office Memorandum F.No.1/6/69/-ITCC, dated 21-8-1969, Instruction No. 1914 was issued by the CBDT on 21-3-1996, Office Memorandum dated 29-2-2016, and Office Memorandum bearing number F. No.404/72/93 – ITCC dated 31-7-2017. The Court held that these Circulars and Instructions are in the nature of guidelines issued to assist the assessing authorities in the matter of grant of stay and cannot substitute or override the basic tenets to be followed in the consideration and disposal of stay petitions. The existence of a *prima facie* case for which some illustrations have been provided in the Circulars themselves, the financial stringency faced by an assessee and the balance of convenience in the matter constitute the 'trinity', so to say, and are indispensable in consideration of a stay petition by the authority. The Board has, while stating generally that the assessee shall be called upon to remit 20% of the disputed demand, granted ample discretion to the authority to either increase or decrease the quantum demanded based on the three vital factors to be taken into consideration. The Court observed that the assessing officer had merely rejected the petition by way of a non-speaking order. The Assessing Officer ought to have taken note of the conditions precedent for the grant of stay as well as the Circulars issued by the CBDT and passed a speaking order. The Court observed that the petition seeking stay filed by the assessee was itself cryptic. However it was held that notwithstanding the assessee may not have specifically invoked the three parameters for the grant of stay, it is incumbent upon the assessing officer to examine the existence of a *prima facie* case as well as call upon the assessee to demonstrate financial stringency, if any and arrive at the balance of convenience in the matter. The Assessing Officer was directed to pass orders *de novo* on the stay application filed by the Assessee.

4. Capital Gains – Holding of asset from the date of allotment letter – Long term capital gains.

Pr. CIT vs. Vembu Vaidyanathan [ITA 1459 of 2016, order dt. 22-1-2019, Bombay High Court]

The assessee, an individual, filed the return of income for the assessment year 2009-10. He claimed long term capital gains arising out of capital asset in the nature of a residential unit. During the course of assessment the Assessing Officer examined this claim and came to the conclusion that the gains arising out of sale of capital asset was a short term capital gain. The controversy between the assessee and the revenue revolved around the question as to when the assessee can be stated to have acquired the capital asset. The assessee argued that the residential unit in question was acquired on the date on which the allotment letter was issued by the builder which was on 31st December, 2004.

The Assessing Officer however contended that the transfer of the asset in favour of the assessee would be complete only on the date of agreement which was executed on 17th May, 2008. On appeal, the CIT (Appeals) and the Tribunal held the issue in favour of the assessee relying on various judgments of different High Courts. Reliance was also placed on CBDT circulars. On further appeal by the Revenue, the High Court observed that the CBDT in its circular No. 471 dated 15th October, 1986 had clarified this position by holding that when an assessee purchases a flat to be constructed by Delhi Development Authority (D.D.A.) for which allotment letter is issued, the date of such allotment would be relevant date for the purpose of capital gains tax as a date of acquisition. It was noted that such allotment was final unless it is cancelled or the allottee withdrew from the scheme and such allotment would be cancelled only under exceptional circumstances. It was noted that the allottee gets title to the property on the issue of allotment letter and the payment of installments was only a followup action and taking the delivery of possession is only a formality. The High Court noted that this aspect was further clarified by the CBDT in its later circular No. 672 dated 16th December, 1993. In such circular representations were made to the board that in cases of allotment of flats or houses by co-operative societies or other institutions whose schemes of allotment and consideration are similar to those of D.D.A., similar view should be taken as was done in the board circular dated 15th October, 1986. In the circular dated 16th December, 1993 the board clarified that if the terms of the schemes of allotment and construction of flats/houses by the co-operative societies or other institutions are similar to those mentioned earlier Circular No. 471 such cases may also be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act. The Court held that the entire issue has been clarified by the CBDT in its abovementioned two circulars. In terms of such clarifications, the date of allotment would be the date on which the purchaser of a residential unit can be stated to have acquired the property. The Court observed that there was nothing on record to suggest that the allotment in construction scheme promised by the builder in the said case was materially different from the terms of allotment and construction by D.D.A. In that view, Court held that the CIT appeals and the Tribunal correctly held that the assessee had acquired the property in question on 31st December, 2004 on which the allotment letter was issued.

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There is no limit to the power of the human mind. The more concentrated it is, the more power is brought to bear on one point.

— *Swami Vivekananda*

When an idea exclusively occupies the mind, it is transformed into an actual physical or mental state.

— *Swami Vivekananda*

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Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

Unreported Decisions

1. Section 23 – The deemed rental income of the properties which are held as stock-in-trade cannot be taxed under the head Income from house property

M/s. Shree Balaji Ventures vs. ITO [ITA 1914/PUN/2018](Assessment Year: 2015-16), Order dated 19-2-2019

Facts

The assessee is engaged in the business of Construction and Development. The assessee has shown unsold residential, commercial units as well as show rooms as stock-in-trade in its books of account in the year under consideration. In the course of assessment proceedings, the learned AO observed that one office building and a showroom were shown by the assessee as a part of closing stock and he opined that the deemed rental income from the said properties must be taxed u/s. 23(4) of the Act. Being aggrieved by the said assessment order, the assessee preferred an appeal before the learned CIT(A) but did not get any relief. Therefore, the appeal was preferred before Hon'ble ITAT. After hearing both the sides, Hon'ble ITAT has observed as under:

Held

Hon'ble ITAT held that the assessee was holding two properties as a part of stock-in-trade of which the deemed rental income has been computed as per section 23(4) of the Act by the learned AO. The case of the learned AO was that since the assessee is the owner of the properties, the deemed rental income from the same has to be taxed under "Income from House Properties" even though the properties are held as a stock-in-trade. To come to this conclusion, the learned AO placed reliance on the decisions of Hon'ble Supreme Court in the case of *East India Housing & Land Development Trust vs. CIT [1961] 42 ITR 49 (SC)* and *S. G. Mercantile Corporation Pvt. Ltd. vs. CIT [1972] 83 ITR 700 (SC).* After considering the said decisions, Hon'ble ITAT observed that the law laid down by Hon'ble Supreme Court in these cases has been transformed in the subsequent decision of Hon'ble Supreme Court in the case of *Chennai Properties and Investment Ltd. vs. CIT [2015] 373 ITR 673 (SC).* In the said case, Hon'ble Supreme Court held that when the main object of the assessee is to acquire the properties and earn income by letting out the same, the income received thereon is to be taxed as business income and not as income from house property. Further, Hon'ble ITAT observed that the same ratio has been upheld

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by Hon'ble Supreme Court in the case of *Rayala Corporation Pvt. Ltd. vs. ACIT [2016] 386 ITR 500 (SC).* After considering the said decisions, Hon'ble ITAT held that the authorities below were not justified in computing the annual letting value of the unsold properties lying with the assessee as a stock-in-trade u/s. 23(4) of the Act. It was further held that once the income of a builder in respect of letting out the properties is chargeable under the head "Profit and Gains of Business or Profession", the provisions under Chapter IV-D get magnetised and the same would fall under the head Income from House Property. Hon'ble ITAT noted that the assessee in this case admittedly did not earn any rental income from letting out of these two units and the said position has also not been disputed by the learned AO. In view of the same, it was held that taxing any hypothetical income, which is otherwise not sanctioned by any provision under Chapter IV-D, cannot be permitted. On the aforesaid observations, the appeal of the assessee was allowed and the learned AO was directed to delete the addition made u/s. 23(4) of the Act.

2. Section 69 – Withdrawals of cash in the past as a source of deposit at a later point cannot be disbelieved merely on the surmise revenue authorities were not competent to dictate as to what the assessee should do with the money withdrawn from the bank

Shri Sampathraj Rakesh Kumar vs. ITO, Bangalore [ITA 1451/Bang/2018] (Assessment Year 2014-15) dated 3-10-2018

Facts

The assessee is an individual and the Assessment Year under consideration is 2014-15. For the said Assessment Year, the learned AO during the course of assessment proceedings observed that the assessee has deposited ₹ 25,00,000/- in his bank account and asked the assessee to explain the same. Pursuant thereof, the assessee submitted before the learned AO that the said cash deposits were made out of the cash withdrawn by the assessee in the preceding financial years. However, the learned AO did not accept the same and the assessment was completed by adding an unexplained cash deposit of ₹ 25,00,000/- u/s. 69 of the Act. Being aggrieved, the assessee preferred an appeal before the learned CIT(A) and filed statement showing withdrawals from April 2009 till May 20019 as a source of lump sum cash deposits of ₹ 25,00,000/-. However, the same was rejected by the learned CIT(A) on the reasons that having regard to the human probability and the normal course of human conduct, it is not believable that the said cash deposits were made out of the cash withdrawal which were almost two years prior to the deposits. Thereafter, the appeal was preferred before Hon'ble ITAT and it was submitted that the source of cash deposits was duly explained by the assessee before both the lower authorities. To buttress the contention, the assessee heavily relied upon the decision of Hon'ble Karnataka High Court in the case of *"S.R. Venkataraman vs. Commissioner of Income Tax."* On the other hand, the learned DR relied upon the learned CIT(A). After hearing both the parties, Hon'ble ITAT held as under.

Held

Hon'ble ITAT perused the bank statement filed by the assessee and noted that there was sufficient cash balance available with the assessee at the time of the said cash deposits. With regard to the observation of both the authorities holding that it was highly improbable for a person to keep withdrawals for more than two years, Hon'ble ITAT notice that Hon'ble Karnataka High Court had already taken a view on the above mentioned issue and came to the conclusion that withdrawals of cash in the past as a source of deposit at a later point cannot disbelieved merely on the surmise revenue authorities were not competent to dictate as to what the assessee should do with the money withdrawn from the bank. After noticing the aforesaid observation of Hon'ble Karnataka High Court, the claim of the assessee was accepted by Hon'ble ITAT and the appeal was allowed.

3. Section 251 – The learned CIT(A) is under obligation to decide an appeal on merits despite the fact that the assessee has filed a letter for a withdrawal

M/s. Deekay Gears vs. ACIT [ITA 2366/Mum/2018] (Assessment Year: 2009-10), order dated 16-1-2019

Facts

The assessee is a partnership firm and the Assessment Year under consideration is 2009-10. For the said Assessment Year, the assessee filed its return of income declaring the total income at ₹ 17,90,190/- which was later on scrutinised u/s. 143(3) of the Act. Subsequently, the learned AO received the information from the investing wing regarding hawala/bogus purchases and reopened the assessment u/s. 147 r.w.s. 148 of the Act. In the reassessment proceedings, the learned AO estimated the profit @ 12.5% on the alleged bogus purchases and passed the reassessment order u/s. 147 r.w.s. 143(3) of the Act which was challenged by the assessee before the learned CIT(A). During the course of appellate proceedings, the assessee filed a letter dated 19-9-2017 and sought withdrawal of the appeal. The said request was accepted and the learned CIT(A) dismissed the said appeal as withdrawn without dedicating the issue in appeal on merits. Later on, the assessee preferred an appeal before Hon'ble ITAT and submitted that one of the partners who was non-conversant with income tax proceedings sought withdrawal before the first appellate forum. It was further submitted a partner who was looking after income tax proceedings regularly was ill and could not attend to the present appellate proceedings due to which the other partner who sought the withdrawal of the appeal had to look after it. The request was made to the Hon'ble ITAT to restore the matter back to the file of the learned CIT(A). On the other hand, the learned DR submitted that it was not necessary for the CIT(A) to adjudicate the issue on merits and opposed the contention of the Assessee. After hearing both the parties, Hon'ble ITAT held as under.

Held

Hon'ble ITAT in the first place perused the provision of section 251 of the Act and observed that the first appellate authority is conferred with the power to decide an appeal against an order of assessing officer by confirming, reducing, enhancing or annulling of the same. It was further noticed by Hon'ble ITAT that the power to set-aside an assessment order which earlier was available with the first appellate has been taken away w.e.f. 1-6-2001. Hon'ble ITAT referred to the decision of Hon'ble Bombay High Court in the case of *CIT vs. PremkumarArjundas Luthra (HUF) reported at [2017] 297 CIT 614* and came to the conclusion that once an appeal before the first appellate authority is filed, notwithstanding the fact that the assessee has filed the application seeking the withdrawal of the same, the learned CIT(A) is under obligations to decide an appeal on merits as per the provisions of section 251(1)(a) of the Act. Finally, Hon'ble ITAT set aside the impugned order to the learned CIT(A) for de novo at adjudication. In light of the same, the appeal filed by the assessee was allowed for statistical purpose.

Reported Decisions

4. Section 45 r.w.s 2(47) of the Act r.w.s 53A of the Transfer of Property Act, 1882 – The transfer of leasehold rights by virtue of

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an unregistered agreement of assignment of the same is not a valid transfer as per section 2(47) r.w.s. 53A of the Act even though the assessee received certain amount and handed over the possession of the lease hold rights

Mallika Investment Co. Pvt. Ltd. vs. ITO [ITA 1245/KOL/2015] (Assessment Year : 2008-09), Order dated 12-12-2018, [2019] 174 ITD 386 (Kolkata – Trib.), [2019] 101 taxmann.com 48 (Kolkata – Trib).

Facts

The assessee is a Private Limited Company and the assessment year under consideration is AY 2008-09. The assessee filed its return of income for the impugned assessment year on 24-9-2012 declaring total income of ₹ 7,89,577/-. During the course of assessment proceedings, the learned AO observed that the assessee received a sum of ₹ 1,75,00,000/- from M/s. Improved Realtors Pvt. Ltd. by virtue of an unregistered agreement of assignment of the leasehold rights dated 17-8-2007. According to the learned AO, the assessee was liable to be taxed on the capital gains since the transaction for which assessee received the amount fell within the scope and ambit of Section 48 of the Act r.w.s 2(47)(v) of the Act r.w.s 53A of TOPA, 1882. Before the learned AO, the assessee contended that, it was not the owner of the said property and was in possession of the property only in the capacity of a lessee by virtue of a duly executed Indenture of Lease drawn on 14-2-1970. It was further submitted that since the assessee was not the owner of the immovable property and had no power to transfer the right, title and/or interest as an owner to anyone, there was no valid transfer within the meaning of sec. 2(47)(v) of the Act. However, the learned AO without appreciating the explanation of the assessee held that since the consideration was received and the possession was also handed over during the relevant year, there was deemed transfer of a 'Capital asset' as per section 53A of TOPA, 1882. On the aforesaid conclusion, the learned AO added the entire value of consideration of ₹ 1,75,00,000/- as LTCG. Being aggrieved, the assessee preferred an appeal before the learned CIT(A) who confirmed the action of learned AO. The assessee, thereafter, preferred the appeal before Hon'ble ITAT. After considering the submissions of both the parties, Hon'ble ITAT has held as under:

Held

Hon'ble ITAT observed that the document in question which was an agreement of assignment of property wherein the assessee was having only leasehold rights was not registered till 31-3-2008. It was further, held that the position which existed earlier that an agreement of sale which fulfilled the ingredients of section 53A of TOPA, 1882 was not required to be executed through a registered instrument, has changed by the Registration and other related Law (Amendment) Act 2001. The Amendments were made simultaneously in section 53A of TOPA, 1882 and Section 17 and 49 of the Indian Registration Act, 1908. By way of amendments, the words "the contract, though required to be registered, has not been registered, or" in section 53A of TOPA, 1882 have been omitted. Further, sec 17 and 49 of Registration Act, 1908 have been amended, clarifying that unless the documents containing the contract to transfer for consideration any immovable property is registered, it shall not have any effect in law. In view of the same, Hon'ble ITAT held that in this case by no stretch of imagination an agreement for assignment can be held as transfer of an immovable property as per section 53A of TOPA, 1882 in absence of an unregistered agreement. Further, Hon'ble ITAT relied on the decision of Hon'ble Supreme Court in the case of *CIT vs. Balbir Singh Maini [2017] 398 ITR 531*. Further, it was observed that any profit or gain arising from the transfer of a capital asset is chargeable to tax under the head

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"capital gain" and is deemed to be the income of the financial year in which the transfer took place. The reliance was placed on the decision of Hon'ble Karnataka High Court in the case of *Syndicate Bank Ltd. vs. ACIT [1985] 155 ITR 681 (Kar).* In light of the above, Hon'ble ITAT held that the issue of taxing the consideration in respect of assignment of leasehold rights needs *de novo* adjudication and the appeal of the assessee was allowed for statistical purpose.

5. Section 40(b)(v) : Since Partnership Deed specifically provided that salary/remuneration to be computed as per s. 40(b)(v); on harmonious interpretation, remuneration to partners is allowable u/s. 40(b)(v) despite the fact that the quantum of the same is not specifically mentioned in the deed

Unitec Marketing Services vs. ACIT [ITA 822/MUM/2018] (Assessment Year 2014 – 2015) Order dated 5-12-2018, (2019) 101 taxmann.com 397 (Mum)(Trib).

Facts

The assessee is a partnership firm and the assessment year is 2014-15. For the said assessment year, the learned AO during the assessment proceedings observed that the firm had claimed remuneration to partners as a deduction u/s. 40(b)(v) of the Act. From the Partnership Deed filed in support of the said claim, it was noted that there was no remuneration clause in the said Partnership Deed. However later on the assessee submitted a deed of rectification and mentioned that due to oversight, the provision of salary and remuneration to partners were excluded in the original Partnership Deed. After examination of the said deed of rectification of Partnership deed, the learned AO observed that the relevant clause neither specified the amount of remuneration payable to each individual working partner nor laid down manner of quantifying such remuneration, which is an important criterion for allowance of deduction u/s. 40(b)(v). Thereafter, the learned AO referred to the CBDT circular No.739 dt. 25-3-1996 and held that the assessee is not entitled for a deduction of the said remuneration. Being aggrieved, the assessee preferred an appeal before the learned CIT(A) but did not find any success. Thereafter, the appeal was preferred to Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the provisions of Section 40(b)(v) clearly show that the amount of remuneration which does not exceed the amount specified in the Act is deductible and the Board has provided that either the amount of remuneration payable to each individual should be fixed in the agreement or the partnership agreement deed should lay down the manner of qualifying such remuneration. It was further noted that the section does not lay down any condition of fixing the remuneration or the method of remuneration in the partnership deed. All that the section provides is that in case the payment of remuneration made to any working partner is in accordance with the terms of the partnership deed and does not exceed the aggregate amount as laid down in the subsequent portion of the section the deduction is permissible. Thereafter, Hon'ble ITAT came to the conclusion that the provisions of Section 40(b)(v) as well as clause of the partnership deed are to be interpreted harmoniously. Clause-6 of partnership deed of the assessee specifically contains that the salary/remuneration is to be computed as provided in section 40(b)(v) or any statutory enactment thereto. On the aforesaid conclusion, the claim of the assessee towards remuneration paid to partners was allowed and the Appeal was decided in favour of the assessee and against the Revenue.

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CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Accentia Technologies and TCS E-Serve Ltd. are not comparable to the assessee providing ITeS. No question of law arose where the Tribunal had remanded the issue with respect to interest on outstanding receivables considering the jurisdictional High Court decisions.

Pr. CIT vs. Inductis (India) Pvt. Ltd. – [TS-88-HC-2019(DEL)-TP] – ITA No. 144 of 2019

Facts

i) In the TP study, the assessee had characterised itself as a captive contract IT enabled Service (ITeS) provider. It applied TNMM and selected 12 comparables having an arithmetic mean of the margins thereof at 16.33% *vis-à-vis* its own margin of 19.55% and, thus claimed the transaction to be at ALP.

ii) However, the TPO proposed 8 comparables having an average margin of 29.57% and accordingly made an adjustment to provision of ITeS. The DRP rejected 4 comparables selected by the TPO and made a downward adjustment.

iii) Further, the TPO made an addition by treating the outstanding receivables pending beyond a 90-day period as loan and imputed an interest of Libor+300 bps. The said adjustment was affirmed by DRP.

iv) The Tribunal accepted assessee's plea to exclude Accentia Technologies on ground that (i) it was engaged in development of software product and (ii) it was rendering diversified services like LPO, KPO and segmental information was not available. The Tribunal excluded TCS E-Serve Ltd. noting that (i) it was engaged in nature of servicing and maintenance of software testing, verification and validation of software falling within category of software development services and (ii) it had made payment for use of brand "TATA" which had increased its operating profits.

v) As regards the interest on outstanding receivables issue, the Tribunal remanded the matter following the Co-ordinate Bench decision in the case of *Orange Business Services India Solutions Pvt. Ltd. vs. DCIT [ITA No. 6570/Del/2016]* wherein also the said issue was remanded to verify as to whether on analysis of the receivables statistic over a period of time discerned a pattern which would indicate that the arrangement intended to benefit AEs and

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also if the interest to be charged was subsumed within working capital.

vi) In the aforesaid case, the Co-ordinate Bench had relied on the Jurisdictional High Court decision in the case of *Avenue Asia Advisors Pvt. Ltd. vs. DCIT (2017) 398 ITR 120 (Del.)* wherein the Court had directed the TPO to study the impact of the receivables appearing in the accounts of the assessee, looking into the various factors as to the reasons why the same are shown as receivables and also as to whether the said transactions can be characterised as international transactions, applying the ratio of *Kusum Healthcare (2017) 398 ITR 66 (Del.).* In Kusum Healthcare (supra), it was held that separate adjustment on account of outstanding receivables is not required, if the impact of receivables on the working capital is already factored in the pricing/ profitability of the assessee and its comparables.

vii) Aggrieved, the Revenue filed an appeal before the High Court.

Held

i) The Court dismissed Revenue's appeal with respect to exclusion of comparables viz., Accentia Technologies Ltd., and TCS E-Serve Ltd., holding that it was not a question of law but a factual one, which was decided by the Tribunal and did not call for any interference.

ii) With respect to interest on outstanding receivables, the Court held that the Tribunal had remanded the matter for factual analysis after considering the High Court decisions and hence no question of law arose.

iii) Accordingly, the Revenue's appeal was dismissed.

2. TNMM is the MAM and not CUP method where (i) there are various differential factors such as geography, volume, risk, functions, etc., between the transactions with the AEs and the third parties and (ii) no suitable adjustment can be made to the ALP determined as per CUP method

Pr. CIT vs. Amphenol Interconnect India P. Ltd. – [TS-56-HC-2019 (Bom)-TP] – ITA No. 1393 of 2016

Facts

i) The assessee was engaged in the manufacturing of electronic connectors, accessories, cable assemblies and system intergrations for application in various industries such as military, aerospace and telecom etc. The same were specialised and customised in nature and manufactured against only specific orders.

ii) For AY 2009-10, the assessee had benchmarked the manufacturing segment by aggregating all the transactions with its AE viz. export of finished goods, import of raw materials, import of capital goods and commission paid and applying TNMM.

iii) The TPO was of the view that the aforesaid transactions had to be separately benchmarked and CUP was the MAM since the assessee exported same products to third parties, imported same goods from third parties and also made payment of commission to third parties. Accordingly, the TPO made an adjustment applying CUP to the said transactions, which was upheld by the DRP.

iv) The Tribunal deleted the adjustment relying on the Coordinate Bench decisions in assessee's own case for earlier years viz., AY 2005-06 to AY 2008-09. Noting that TPO had applied CUP assuming product similarity for export of goods and import of goods, the co-ordinate Bench had held that CUP was not the MAM to determine ALP in case of the assessee since it manufactured customised product. Further, it had held that there were various differential factors between the third parties and the AEs such as geographical location of customer, volume of order, timing of order, risk, functions and others which would affect the pricing of product and for which suitable adjustments could not be made in the instant case.

v) With respect to adjustment made towards commission also, the Co-ordinate Bench had noted that there were vast differences in functions performed and thus, concluded that the TPO had wrongly applied CUP for the said transaction.

vi) Further, it was held that assessee had rightly aggregated the aforesaid transactions under TNMM as the transaction were closely inter-linked i.e., transactions of exports, imports and payment of commission were part of business activity of assessee of manufacturing connectors and selling them subsequently to third parties. Accordingly, the Tribunal deleted the adjustment.

vii) Aggrieved, the Revenue filed an appeal before the High Court.

Held

i) The Court noted that Revenue's appeal against the Tribunal's order for earlier years viz., AY 2005-06 to AY 2008-09 was already dismissed by the Court with the following observations:

(i) The Tribunal had done the necessary FAR analysis to come to the conclusion that CUP method was not the MAM owing to geographical differences, timing differences, risk differences and functional differences for which adjustment could not be made.

(ii) The selection of TNMM method by the Tribunal was a possible view on application of appropriate tests and the Revenue had also not shown such selection to be perverse.

(iii) With respect to commission payment, the Tribunal held that CUP was not the MAM on account of difference in respect of function and geography between AE transaction and third party transaction after analysing the difference in sales commission paid to its AE and commission paid to third party agents. Accordingly, the Tribunal's conclusion that TNMM was the MAM was a reasonable and possible view on application of appropriate test in present facts.

ii) Accordingly, it dismissed Revenue's appeal for the present year also, following its own order for the earlier years.

3. Company having abnormal profit margin for the year cannot be considered as comparable for ALP determination. ACE Software Exports Ltd., is functionally comparable to entity rendering design engineering services

PCIT vs. Honeywell Turbo (I) Pvt. Ltd. [TS-80-HC-2019 (Bom.)-TP] – ITA No 877 of 2016

Facts

i) The assessee-entity was *inter alia* engaged in providing business support services and design engineering services to its AE. It unsuccessfully objected before the AO and DRP against the TPO's selection of ICRA Online Ltd. as a comparable for benchmarking its business support services.

ii) The Tribunal excluded the above comparable, noting that the operating margin for relevant year was abnormally high compared to earlier years.

iii) Further, the TPO and DRP had excluded ACE Software Exports Ltd. as comparable for benchmarking design engineering services on the ground of functional dissimilarity and that it was a loss making enterprise. On assessee's appeal against the said exclusion, the Tribunal decided in favour of the assessee holding that (i) the transactions rendered fell broadly in a similar category as assessee and (ii) the company was not a persistent loss making unit.

iv) Aggrieved, the Revenue filed an appeal before the High Court against the Tribunal's order excluding ICRA online Ltd. and including ACE Software Exports Ltd. for benchmarking the aforesaid services.

Held

With respect to exclusion of ICRA Online Ltd. :

i) Noting the reliance placed by the Revenue on Special Bench decision in case of *Maersk Global vs. CIT [ITA No. 7466/Mum/2012]* to contend that high profit margin would not justify exclusion of a company, the Court held that the said Tribunal ruling was to be applied when the high profit margins were a normal business condition and not peculiar to the comparable.

ii) It noted that the Tribunal in the present case, after noting the above ruling of Special Bench and the decision in the case of *Barclays Technology Centre India Pvt. Ltd. [ITA No.1384 of 2015 (Bom.)]* wherein it was held that mere high profit margin would not warrant an exclusion of a company from the final list of comparable, had found on examination of facts that the profit margin declared by ICRA Online Ltd., did not reflect a normal business profitability and, therefore, excluded the same from the list of comparables.

iii) The Court noted the Tribunal's finding that profit margin of ICRA Online for the subject year was 63.33% which was quite abnormal *vis-a-vis* the profit margin for preceding years i.e. 8.59% and 25.98% while the profit margin for subsequent year was 26.78%.

iv) Accordingly, it held that the view of the Tribunal was essentially a finding of fact which was not shown to be perverse in any manner.

With respect to inclusion of ACE Softwares Exports Ltd.:

v) The Court noted the Tribunal's observation that engineering segment of assessee involved CAD/CAM services which fell in the broad category of IT enabled Services, similar to ones performed by ACE Softwares Exports Ltd.

vi) It also noted that the Tribunal's finding that ACE Software Exports Ltd., was not a persistent loss making unit and the loss suffered in the relevant AY was on account of normal business and not on account of factors beyond the normal business environment.

vii) Accordingly, the Court concluded that the Tribunal's finding was not shown to be perverse in any manner and, thus, dismissed Revenue's appeal on both the above issues.

4. Corporate guarantee commission charged @ 0.20% of guarantee amount is at ALP and bank guarantee commission rates prevalent in market are not relevant for benchmarking the same.

CIT vs Asian Paints Ltd [TS-75-HC-2019(BOM)-TP] - ITA No. 1564 of 2016

Facts

i) The assessee had given corporate guarantee to various banks on behalf of its subsidiary on the loans taken by them and had charged 0.20% of the guarantee amount as commission from its AEs. The TPO determined ALP at 3% on the basis of guarantee commission charged by HSBC Bank and Allahabad Bank and thus made TP adjustment.

ii) The Tribunal relied on the co-ordinate bench decision in assessee's own case for an earlier year wherein identical adjustment was deleted, holding that guarantee commission would vary from transaction to transaction and guarantee rate obtained by mere relying on data from the market without carrying out any comparability analysis of the actual transactions undertaken could not be applied in a blanket manner. The Co-ordinate Bench also noted that the TPO had not provided any information on the financial year for which these rates were applicable, nor any details on the terms & conditions had been made available. Accordingly, the Tribunal deleted the adjustment for the relevant year also.

iii) Aggrieved, the Revenue filed an appeal before the High Court.

Held

i) The Court dismissed the present appeal noting that Revenue's appeal against the Tribunal decision for the earlier year was also dismissed by the Court, upholding the Tribunal's factual findings and holding that no substantial question of law arose.

Tribunal Decisions

5. India-USA DTAA – Payment of Web Hosting Charges to Amazon Web Services – Whether Royalty – Non-deduction of TDS u/s. 195 – Section 9(1)(vi) r/w. Sec. 40(a)(i) – Held : Payment did not amount to Royalty under the DTAA – In favour of the assessee

EPRSS Prepaid Recharge Services India P. Ltd vs. ITO – [TS-623-ITAT-2018(PUN)] Assessment Year: 2011-12

Facts

i) EPRSS Prepaid Recharge Services India P. Ltd. (assessee) is a Private Limited Company engaged in the distribution of recharge pens of various DTH providers like Sun Direct TV (P.) Ltd., Idea Cellular and to its other distributors via online network.

ii) During subject AY's 2010-11 and 2011-12, assessee had made payments to Amazon Web Services (AWS) for web hosting services which was required to run various online recharges as the facilities such as skilled manpower, maintenance of servers and upkeep was not available with the assessee.

iii) AO noted that assessee was given a "Limited Licence" by means of a "Right to Use" agreement and granted site access to the AWS website for conduct of its activities, for which the assessee was being charged by AWS on a monthly basis. AO rejected the claim of the assessee that there was no liability to deduct TDS as the payment did not fall either in the category of technical fees or royalty payments and was no covered under the Indo-US DTAA.

iv) The AO held that these charges were in the nature of use of commercial equipments within the meaning of amended section 9(1)(vi) read with Explanation 2 and Explanation 5 having retrospective effect and thus partook the nature of royalty. AO disallowed the deduction u/s. 40(a)(i) on account of non-deduction of TDS on the said payments.

v) Upon further appeal, CIT (A) upheld the order of AO in holding that the payment made by assessee is covered by the term "Royalty" as per amended provisions of Explanation 2(iva) of section 9(1)(vi) of the Act.

Decision

On assessee's appeal, the Tribunal held in its favour as follows:

i) At the outset, The Tribunal noted that the main issue under consideration was whether the assessee was liable to deduct TDS on account of payments to Amazon for web hosting charges.

ii) On perusal of records, the Tribunal observed that the agreement did not pass on any IPR right or rights in technology. Moreover, even though there was an amendment in the year 2012 with retrospective effect, under which Explanation 5 had been inserted u/s. 9(1)(vi) of the Act, it could not lead to retrospective TDS obligation.

iii) The Tribunal held that once the payments were released in FY's 2009-10 and 2010-11, or shown to have been accrued to Amazon, then even though there is a retrospective amendment, payments already made cannot be withdrawn as this would be an impossible act to perform.

iv) The Tribunal accepted the plea of the assessee that it was clear that retrospective amendment had changed the definition of "royalty" from the year 2012 under the Income- tax Act, but the position of DTAA between two countries had not been affected as no such amendment had been made to the Treaty Laws and in DTAA, i.e., position similar to Explanation 5 was not envisaged at all.

v) The Tribunal observed that if the meaning of royalty was to be construed as per DTAA, the possibility of position and control of server/ server space would also need to be considered which was not possessed by the assessee, hence as per Treaty Laws as well the assessee could not be held to have paid royalty to Amazon.

vi) The Tribunal ruled that as per the courts, it was held that no amendment to the Treaty Laws would override amendments in IT Act. Further, the Tribunal placed reliance in Delhi HC judgment in New Skies Satelite BV [TS-64-HC-2016 (Del.)] which concurred with similar views. Accordingly, the Tribunal concluded that the payment made by assessee for web hosting services was not taxable in accordance with DTAA and the same cannot be held to be taxable, only because there was retrospective amendment to section 9(1)(vi).

vii) The Tribunal further observed that the fees paid by the assessee was paid for the use of technology and cannot be said to be for the use of technology which was proved by the fact that the charges were variable in nature and did not give rise to any right in property of Amazon. Further, the assessee did not use or acquire any right to use any industrial, commercial or scientific equipment while using the technology services provided by Amazon and hence, the payment made by assessee cannot be said to be covered under clause (iva) to Explanation 2 of section 9(1)(vi). The Tribunal placed reliance on *Madras HC in Skycell Communications Ltd. & Anr. [TS-18-HC-2001 (Mad.)]* which concurred with similar views.

viii) The Tribunal concluded that the assessee was not liable to deduct withholding tax and consequently, no disallowance of amount paid as web hosting charges was to be made in the hands of assessee as provisions of section 40(a)(i) of the Act were not attracted.

6. Non-Resident Individual – Salary accrued in USA but received in India – Rejects taxation of salary accrued outside India despite failure to furnish TRC – Held in favour of the assessee

Smt. Maya C Nair vs. ITO [TS-646-ITAT-2018 (Bang.)] Assessment Year : 2013-14

Facts

i) Smt. Maya C. Nair ('assessee') was sent on an international assignment to the USA by her employer during AY 2013-14, the salary was credited to Indian bank account. The assessee claimed exemption in respect of salary earned outside India contending to be a non-resident since her stay in India was less than 182 days.

ii) The AO rejected the assessee's contention since the assessee did not produce confirmation from her employer in India or in the USA to establish that she was working in the USA for the said period, the salary is received in India and that the assessee did not provide Tax Residency Certificate (TRC) for claiming benefit under India-USA DTAA. Therefore, the AO taxed the salary in India.

iii) Initially, the CIT(A) deleted the addition made by the AO since the assessee was non-resident during the year under consideration. Subsequently, the CIT(A) passed another order and upheld the AO's order taxing the salary earned in USA in India.

Decision

On Appeal, The Tribunal held in favour of the assessee as under:

i) The Tribunal noted that during the impugned year, the assessee was non-resident since her stay in India was less than 182 days. It further noted that she had paid the taxes and filed the return in USA. Further, it noted that the assessee had furnished details of her stay abroad, by furnishing details of passport and visa to the Assessing Officer as well as details of taxes paid and tax returns filed in the USA.

ii) The Tribunal relied upon co-ordinate Bench ruling in *ITO vs. Bholanath Pal in ITA No.10/Bang/2011 of ITAT, Bangalore Bench* to hold that as per Section 15, salary is taxable only on accrual basis and it would accrue in USA as services were rendered in USA.

iii) The Tribunal held that requirement to furnish TRC is applicable only when DTAA benefit is claimed. Referring to co-ordinate Bench decision in *Skaps Industries India Pvt. Ltd. vs. ITO [TS-330-ITAT-2018(Ahd.)]*, The Tribunal held that absence of TRC cannot be ground for denial of benefit of DTAA. The Tribunal held that since the assessee has furnished evidence of her stay abroad in the year under consideration before the AO and as the salary for services rendered did not accrue in India for that period of stay outside India, that salary income is not taxable in India.

iv) Separately, regarding 2 orders passed by 2 different CIT(A)s – first favourable to assessee while subsequent order being adverse, The Tribunal held that favourable order was well reasoned and speaking order and it cannot be wished away merely because of a Departmental Administrative Order of the Pr. CCIT transferring the appeal for this particular Assessment Year 2013-14 from the CIT (Appeals) - 12, Bangalore. The Tribunal noted that the mistake was either on the part of the CIT (Appeals) - 12, Bangalore in not implementing the order of the Pr. CCIT, Bangalore OR it is of the Pr. CCIT, in not communicating the order of transfer and the assessee should not suffer hardship and harassment due to mistake of officers of department.

v) The Tribunal noted that when the CIT(Appeals) – 10, Bangalore passed the subsequent *ex-parte* order, the earlier order of the CIT(Appeals)-12 was very much in existence even when it was sought to be invalidated by CIT(Appeals)-12, herself by way of rectification action u/s. 154. Therefore, the Tribunal held that there cannot be two appellate orders of two different CIT(Appeals) on the same appeal at the same time on the very same assessee and therefore, obviously, the subsequent order of the CIT(Appeals) - 10, Bangalore is not a valid order in the eyes of law.

vi) The Tribunal further held that favourable order cannot be recalled by passing order u/s. 154 as there is no such specific power conferred u/s. 154 to recall an order or deem an order as invalid. Thus, the tribunal quashed rectification order u/s. 154.

7. Reimbursement of salary of expatriate Technical and Managerial Personnel – Whether taxable as "Fees for Technical Services: (FTS) or not taxable as "Reimbursement of Expenses" – Held – Taxable as FTS – In favour of the Revenue

Panasonic Corporation vs. DCIT [TS-531-ITAT-2018 (CHNY)] Assessment Year : 2013-14

Facts

i) Panasonic Corporation ('assessee') a company incorporated in Japan, engaged itself in the business of development, production and sale of electrical and electronic products, systems and components for a wide range of consumer, business and industrial uses.

ii) During the course of business activity, Panasonic Corporation Japan deputed some of its employees to Panasonic India Pvt. Ltd. The salary of the employees of Panasonic Corporation Japan, who are working in India, was reimbursed by Panasonic India Pvt. Ltd. The assessee did not offer it to tax since it was only reimbursement. The TPO held that no adjustment was required on the reimbursable expenditure received by the assessee.

iii) However, the AO while passing the draft assessment order disallowed the claim of the assessee on the ground that the assessee received fee for technical service and not reimbursement of salaries on which he failed to deduct tax. The AO noted that the personnel seconded are all in senior Technical / Managerial positions who report to the President and Vice-President who in turn report to the assessee and hence the ultimate responsibility and the direction, control and supervision of the personnel vested with Panasonic Japan.

iv) The AO further noted that the case of employment with Panasonic India is, unlike an independent employment comes with a lien marked on the employment with the parent and the employee has to only go back to the parent on expiry of their tenure. It further noted that as submitted by assessee there are no termination of employment with Panasonic Corporation, hence the salary paid to the employees of Panasonic Corporation has borne out of the inherent obligation in the Panasonic Corporation as the employer.

v) The AO held that the deputed personnel have come to India, to imbibe the culture of the group and ensure the application of the Panasonic group policies / processes and other quality standards in Panasonic India which clearly demonstrates once the processes and policies are imbibed / retained, there is no need for the personnel again and Panasonic India can apply the same by itself. Hence, he held that the services have also made available the technical knowledge / skill and experience.

vi) The DRP also upheld the order of the AO. The DRP concluded that the receipt has to be considered as fee for technical services in respect of non-resident irrespective of the fact whether it was received with mark up or cost to cost basis.

Decision

On assessee's appeal, the Tribunal held in favour of the Revenue as under:

The Tribunal noted that the employees of Panasonic Corporation Japan are all senior technical / managerial position who reported to the President and Vice-President who, in turn, was expected to report to the assessee herein, the seconded employees have to work as per the direction, control and supervision of the Panasonic Corporation Japan. THE TRIBUNAL held that since the employees deputed by the assessee are high level technical executives and they are rendering highly technical services to Panasonic Corporation India Pvt. Ltd., the payments for such services would fall within the ambit of fee for technical services as defined in Explanation 2 to Section 9(1)(vii). The Tribunal upheld the order of the AO that the technology was made available to the subsidiary in India, therefore, there is no need for the employees of the assessee to come again.

[Remarks: Mumbai Tribunal in *Morgan Stanley Asia (Singapore) Pte vs. DDIT [TS-384-ITAT-2018(Mum)]* had held that payment received by assessee (Singapore company) from its associated enterprise in India towards

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reimbursement of salary for seconded employees, not FTS under Act as well as India-Singapore DTAA. Bombay HC in *Marks & Spencer Reliance India Pvt. Ltd. vs. DIT [TS-178-HC-2017(Bom.)]* had held that payment by *Marks and Spencer Reliance India Pvt. Ltd. to Marks & Spencer Plc, UK.* towards reimbursement of salary for seconded employees, not FTS under India-UK DTAA. However, Bangalore Tribunal in *Emulex Design & Manufacturing Corporation vs. DCIT [TS-294-ITAT-2017(Bang.)]* had held that payment received by assessee (a US company) for services provided under secondment agreement, being technical in nature, constitutes Fees for Included Services (FIS) under Article 12(4) of Indo-US DTAA].

8. India-Philippines DTAA – Rendering of Technical Services by the Philippines Service Provider – Taxability thereof as FTS in the absence of FTS Article in the DTAA – Applicability of Articles 7, 23 and 24 of the DTAA-Held: Not liable to deduct TDS u/s. 195 as not taxable in India-in favour of the assessee

IBM India Private Limited vs. DDIT [TS-78-ITAT-2014(Bang.)] Assessment Years: 2007-08 to 2011-12

Facts

i) The assessee, IBM India Private Limited, is an Indian Company engaged in the business of providing information technology services. For AY 2007-08 to 2011-12 assessee had outsourced certain services such as payroll related services, data management services, benefits administration, balance sheet reconciliation, generation of reports, stock option administration, etc., to IBM Business Services, Philippines (IBM Philippines) and made payments in respect of the same. A notice under Section 201(1) & 201(1A) of the Act was issued to the assessee, seeking clarification as to why tax was not deducted at source from above mentioned payments made to IBM Philippines.

ii) Assessee contended that in absence of an article for "Fees for technical services" in India- Philippines treaty, payments constituted 'business profits' under Article 7 of the DTAA and as IBM Philippines did not have PE in India such payments were not taxable in India. Also as per Article 23 dealing with 'Other Income' of the tax treaty, income of IBM Philippines was taxable only in Philippines and not in India.

iii) The AO, after considering assessee's contentions held the assessee as 'assessee in default' for not deducting tax at source on the basis that in the absence of an Article dealing with FTS under the tax treaty, the provisions of Income-tax Act, 1961 (the 'Act') would apply. The AO placed reliance on Article 24 of the Tax Treaty dealing with 'Elimination of Double Taxation' and the CBDT Circular 332 of 1984. On appeal, CIT(A) confirmed the orders of AO.

Decision

On assessee's appeal, The Tribunal held in its favour as follows:

i) The Tribunal proceeded to address the issue whether the payments made by assessee to IBM Philippines were chargeable to tax in India as FTS u/s. 9(1)(vii) of the Act in absence of article dealing with FTS in India–Philippines DTAA. In this regard, the Tribunal considered scheme of India-Philippines DTAA.

ii) The Tribunal referred to Article 24 of the India-Philippines DTAA which dealt with 'Elimination of Double Taxation'. In view of Mumbai Tribunal ruling in BNP Paribus [ITA Nos. 8693 of 1995 and 507 of 2000], the Tribunal noted that said Article 24, being similar to Article 25(1) of India-UK DTAA, confers no right to invoke provisions of domestic laws for classification or taxability of income which is governed by Articles 6 to 23 of the India

Philippines DTAA. Thus, the Tribunal held that "Article 24(1) does not confer right to invoke provisions of domestic law for classification or taxability."

iii) The Tribunal further noted that para 2 of CBDT Circular 332 of 1984 exemplifies what is stated in Article 24 of the DTAA. Thus, the Tribunal held that Article 24 of DTAA and the said CBDT Circular had no role to play in classification of income or allocation of right to tax such income to one or both the contracting states as the same are to be dealt in accordance with Articles 6 to 23 of the DTAA. Therefore, the Tribunal remarked that Article 24 only eliminated double taxation.

iv) In view of above, the Tribunal held that the contention of Revenue that in absence of an Article dealing with FTS, provisions of the IT Act would apply was not correct. The Tribunal explained that Article 24 of the DTAA has no applicability for taxation of item of income i.e., FTS. Thus the finding of lower authorities that "the payment made to IBM Philippines was taxable u/s. 9(1)(vii) of the Act on the basis of Article 24(1) of India-Philippines DTAA" was incorrect.

v) The Tribunal further held that in the absence of an Article dealing with 'FTS', payments made for services rendered in course of business would be covered by Article 7 of the tax treaty dealing with 'Business Profits' and not by Article 23 of the tax treaty dealing with 'Other Income'.

vi) The Tribunal observed in view of the nature of services rendered and the terms of contract, that the services provided by IBM Philippines were in the course of the business and hence the payments received by it from the assessee partake the character of business profits under Article 7 of India-Philippines DTAA. The Tribunal noted that this conclusion was supported by the Bombay HC ruling in *Christiani & Nielsen Copenhagan (1991) 39 ITD 355; Tekniskil (Sedirian) Berhard (1996) 221 ITR 551(AAR); Channel Guide India Ltd.*, and *Exotic Fruits Pvt Ltd. (ITA No. 1008 to 1013/Bang/2012).* The Tribunal distinguished various rulings relied upon by the Revenue on facts.

vii) The Tribunal further held that "even if it is assumed that payments to IBM Philippines were not covered by Article 7 dealing with 'Business Profits', the said payments were covered by Article 23 dealing with 'Other Income' of the tax treaty. As per Article 23 dealing with 'Other Income', the said payments were chargeable to tax only in Philippines and not in India."

viii) Thus the Tribunal concluded that payments made by assessee to IBM Philippines were not liable to TDS u/s. 195 of the Act and thus the assessee could not be held as assessee in default u/s. 201(1A) of the Act.

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CA Aumkar Gadgil

INDIRECT TAXES
GST Gyan

INTERPLAY OF FTP AND GST – Advanced Authorisation and Refunds / Exemptions under GST

The "Foreign Trade Policy" of the Government of India, has been introduced with the intention to help India emerge as one of the major players in the export market. Having said so, the Government had always one objective in mind, if the exporters are provided a motivating environment, then the larger dream of seeing India achieve a respectable position in global trade would become achievable. The growth story got a substantial booster since the "Liberalisation Policy" in trade was introduced back in 1991-92. Ever since then the Government of India with the specific arm of "Ministry of Commerce and Industry" has been playing a crucial role to keep the exporters moving and provide them stimulation in order to achieve more and more exports. The objective of the "Foreign Trade Policy" although was not just to earn foreign exchange, but also generate a huge opportunity for employment. As a part of the functioning of the entire policy, having a regulated import mechanism has also been an integral part of it. The foreign trade policy envisages various incentive schemes for the manufacturers as well as service providers. "Duty Exemption/Duty remission" schemes provide a platform whereby "Pre Export/Post Export" performance benefits are available to the manufacturer exporter (including the supporting manufacturer in case of merchant exporter).

What is Advanced Authorisation?

Advanced Authorization is a duty exemption scheme. The Advanced authorization licence is issued for the duty-free procurement of inputs which are physically incorporated (with the normal wastage allowance) in the export product. Besides the inputs, supportive production products such as fuels, catalyst, oils are also allowed to be procured duty-free. The advanced authorisation licence is issued on the basis of export performance achieved or on the basis of an undertaking to achieve an export obligation along with a minimum value addition on the value of imported goods. The duty-free procurement is however allowed on basis of pre-calculated and permitted

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quantity which may be based on either of the following.

1. As per the SION (Standard Input Output Norms) which have been laid down in the "Hand Book of Procedures". In this case, the quantity of inputs for a unit of output has been predefined under the Foreign Trade Policy. Thus the duty-free procurement is allowed for such predefined quantity only.

2. On the basis of Self-Ratification in the case where there are no fixed Standard Input Output Norms/ Adhoc norms or where the exporter intends to use additional inputs, in such case the eligible exporters can apply for such self-ratification basis.

3. Besides the above, there are certain fixation norms which can be on the basis of a specific application made by the exporters.

Who is an eligible applicant for seeking advanced authorisation?

1. The eligible applicant can be either a manufacturer exporter or a supporting manufacturer tied to a merchant exporter. That is to say, the advanced authorization is applicable only in case of a manufacturer and not in case of a service provider.

Apart from the meeting of "Export Obligation, is there a Minimum Value Addition criteria?

1. Minimum value addition of 15% needs to be achieved, that is to say, the Export realisation *vis-a-vis* CIF value of imports should be at least 15% more. This is to ensure that the exemptions given at the time of procurement of goods is not only meant for achieving exports for the namesake but should genuinely end up in helping a positive value creation for the country. For certain notified goods, the rates of minimum value addition which may be less than 15% have been separately listed in the "Hand Book of Procedures".

Pre-import condition and actual user condition under Advanced Authorisation

1. Pre-import condition

Chapter 4.13 of the Foreign Trade Policy envisages the possible introduction of "Pre-import conditions" under notified circumstances. Pre-import condition refers to the availability of exemptions from duty on procurements only in the case where the inputs, which are procured duty-free and are used in the manufacture and export of final product, made using it. That is to say that the duty-free procurement under advanced authorization will not be eligible in the case where the exports are achieved in anticipation of advanced authorisation. While it would be pertinent to note that Chapter 4.27 of the FTP Hand Book of Procedures covers in its ambit the eligibility of exports in anticipation of advanced authorization. In the lines of the basic structure of the Foreign Trade Policy, with the introduction of Notification No. 18/2015 Customs, issued on 1st April 2015, the exemption from duty on procurement of inputs under advanced authorisation was available under two scenarios, viz on the basis of procurement before the discharge of export obligation or in respect of procurement made after the discharge of export obligation. Thus the pre-import condition was not covered under the referred notification. That is to say that the open-ended structure of the advanced authorisation policy was maintained by virtue of referred notification.

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However, there was a change probably and a non-welcoming one, *vide* introduction of Notification 79/2017 Customs dated 13th October 2017, whereby the duty exemptions on the procurement of inputs against advanced authorisation was made subject to pre-import condition. Thus with effect from 13th October 2017, the eligibility of procurement of duty-free goods was only in cases where the import was made prior to export, that means the facility to import, after discharge of export obligation got suspended. Although this was not explicitly suspended the implied understanding of imposition of a pre-import condition would be the same.

2. Actual user condition

Actual user condition refers to utilisation of the duty-free procured material in the manufacture of dutiable products which are to be exported. The goods so procured under the advanced authorisation are not allowed to be transferred even after completion of export obligation. Where CENVAT/Input tax credit facility has been availed even after completion of export obligation, in such case the inputs so procured under the advanced authorisation will have to be utilised only in the manufacture of dutiable goods also in such case the inputs such not be transferred. A Certificate to the effect of meeting the "Actual user condition" needs to be obtained from a Chartered Accountant, and the same is required to be submitted at the time of filing of "Export Obligation discharge certificate". However, the actual user condition is not applicable in case of "waste and scrap" arising out of processing of the inputs, in such case the waste and scrap can be sold with payment of applicable duties.

Exemption from IGST under Advanced Authorisation

The discussion in this regard can be divided into various time lines. Goods and Services Tax was introduced with effect from 1st July 2017. However, the exemption from IGST during various time lines can be observed as follows.

1st July 2017 to 12th October 2017

Notification 26/2017 Customs, issued on 29th June 2017 envisaged in its ambit exemption from CVD and special CVD along with other Custom duties in the case where the goods were procured under advanced authorisation. However, nothing was mentioned regarding exemption from IGST or GST compensation cess. Therefore for this time period, it was implied that the IGST was to be paid and the credit of the same was available. The credit so availed could be utilised to pay IGST or the same could have been claimed as refund as a reason of "Zero-rated supply". However, the issue was that the refund mechanism was not in place really effectively and was leading to a cash blockage.

13th October 2017 to 31s December 2018

Notification 79/2017 Customs issued on 13th October 2017, brought in the exemption from payment of IGST and GST compensation cess. By virtue of this notification the exemption was granted, however, the said exemption was subject to "pre-import condition". Also, the availability of exemption was introduced with a rider that the export obligation could be met only by way of "Physical Exports". That is to say, exports other than physical exports viz deemed exports, supply against advanced authorization were considered as ineligible in order to avail the said exemption. Since this notification, there has been a series of representations made by trade bodies, registered persons. Also "DRI" inquiries for incorrect availment of exemption (in cases where exports were made in anticipation of advanced authorisation) were made overall resulted into a dull phase in the tenure of "Advanced Authorization scheme".

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1st January 2019 onwards

Notification 1/2019 Customs, dated 1st January 2019, really came as a breather for the exporters. By virtue of this notification the exemption from the IGST and GST compensation cess was continued to be eligible, also the pre-import condition in respect of inputs was withdrawn. As a result of this now the advanced authorisation can be sought either on basis of export obligation to be achieved or on the basis of exports already achieved. Besides the lifting of the pre-import condition, the export obligation can be met by not only making "physical exports", but also by way of deemed exports, supplies against advanced authorisation.

Restriction on refund options due to advanced authorisation

There have been major set-backs to the exporters with the introduction of refund restrictions where such exporters have been availing the benefits under the "Advanced Authorisation". Even under this case, there has been a time-based implications during various phases. `

1st July 2017 to 22nd October 2017

During the referred period there was no restriction in claiming a refund of IGST paid on exports by way of rebate mechanism even when the procurement was under the "Advanced Authorization" scheme. The main reason being that during such period (up to 13th October 2017), payment of IGST at the time of imports was mandatory.

23rd October 2017 to 4th September 2018

Notification No. 39/2018 was issued on 4th of September 2018, which really brought in a handful of difficulties for the exporters who had availed advanced authorization. This was because firstly the amendment made in the refund rules blocked the possibility of a claim of refund of IGST paid on output in case of an exporter who had availed benefits under advanced authorisation. Secondly, the amendment was with a retrospective effect. This really resulted in a chaotic situation and substantially had hampered the ambitious exporters availing benefits under advanced authorisation.

23rd October 2017 to 4th September 2018

Considering the huge roar over the notification 39/2017, the Central Government came up with another notification number 53/2018 (Central tax), which replaced the time as covered by Notification 39/2018. Thus for the period (23 October 2017 to 8th October 2018), the refund rules permitted the refund of IGST paid on export even in case of a manufacturer who was holding Advanced Authorisation.

9th October 2018 onwards

Referring to Notification 54/2018, Central Tax, the permissibility of refund of IGST paid on exports has been withdrawn for exporters who are procuring duty-free inputs under advanced authorisation. Thus as a result of this, the option for an exporter holding advanced authorisation, to claim a refund on basis of IGST paid on exports has been blocked. Thus an advanced authorization holder would be eligible only to claim a refund of unutilised ITC and will have to carry out exports without payment of IGST on exports under a LUT. The said exporter would, however, be entitled to claim a refund of unutilised ITC balance.

Legal updates on the above issue

The legal issues, under the "Advanced Authorisation" scheme, have been very largely discussed. The inception of all the legal disputes was on the basis of notices/ letters issued by the "Department of revenue intelligence". The reason for such notices/

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letter's was alleged non-compliance "pre-import conditions" which was imposed with effect from 13th October 2017, by virtue of Notification 79/2017 Customs.

Case 1: ***M/s. Maxim Tube Company vs. Union of India***

Hon'ble High Court (Guj.) struck down the pre-import condition and the summary of the decision is as follows

If the interpretation of condition of physical exports and pre-import condition by DRI is accepted, it becomes more or less impossible to make exports under advance authorisation without violating the condition of pre-import due to the business cycle of an exporter, and the benefit of exemption from levy of IGST and compensation cess becomes more or less for namesake. Export in anticipation of advance authorisation as per para 4.27 of the Handbook of Procedures and the imposition of pre-import condition creates a conflicting point in reference to the policy. The pre-import condition as mentioned in the customs notification and para 4.14 of the FTP does not compliment rather conflicts.

The pre-import condition renders the very scheme of advance authorisation as partially effective; also does not have any nexus to the objective of the advance authorization scheme thus goes against the very basic structure of the policy.

Case 2: ***M/s. Vedanta Limited vs. Union of India***

Hon'ble Madurai High Court in case of Vedanta Limited held that the imposition of "pre-import condition is very much in the spirit of the advanced authorization scheme. Also, the actual user condition compliance is an inevitable part of the scheme. Besides this, Hon'ble High Court also ordered the DRI to complete its inquiry.

Although the two judgments are conflicting, the decision given by Hon'ble Guj. High Court has clearly directed the DRI authorities to drop inquires in respect of non-fulfilment of pre-import conditions.

Besides the judgments given by the respective courts, yet it is not clear as to what would be the fate of those exporters who have not complied with the "pre-import" condition but have still claimed the "Advanced Authorisation". The spirit of the schemes should not be taken away is what needs to be ultimately achieved. Even though the condition put up by notification is clear enough, imposing such a condition in itself worry's me as it may really end up resulting in defeating the very purpose of such schemes. Otherwise, the mode of operation set out, at the introduction of any such policy should be consistently followed which would avoid any such confusion and would also help in reducing litigations in their respect.

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> The world is ready to give up its secrets if we only know how to knock, how to give it the necessary blow. The strength and force of blow come through concentration.
>
> — *Swami Vivekananda*

CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

The authors have tried to cover GST updates pertaining to law points in particular. The notifications, circulars, orders relating to extension of various statutory due dates are not covered herewith.

A. IGST Rate Notifications

1. **Removal of exemption of IGST on supply of services in Nepal or Bhutan against payment in Indian Rupees** *(Notification No. 02 /2019 – Integrated Tax-dated 4-2-2019)*

   Entry No. 10D of Notification No. 9/2017-Integrated Tax (Rate) has been omitted. Entry No. 10D was as under:

   "Supply of service having place of supply in Nepal or Bhutan, against payment in Indian Rupees."

B. CGST Circulars

1. **Amendments in the circulars issued in the previous periods** *(Circular No. 88/07/2019 – GST – Dated 1-2-2019)*

   The CGST (Amendment) Act, 2018, SGST Amendment Acts of the respective States, IGST (Amendment) Act, 2018, UTGST (Amendment) Act, 2018 and the GST (Compensation to States) (Amendment) Act, 2018 have been brought in force with effect from 1-2-2019. Consequent to the GST Amendment Acts, the CBIC has made amendments in the following circulars issued earlier under the CGST Act, 2017:

   – Circular No. 8/8/2017 dated 4-10-2017

   – Circular No. 38/12/2018 dated 26-3-2018

   – Circular No. 41/15/2018 dated 13-4-2018

   – Circular No. 58/32/2018 dated 4-9-2018

   – Circular No. 69/43/2018 dated 26-10-2018

2. **Clarification with regard to mentioning inter – State supplies made to unregistered persons in GST returns** *(Circular No. 89/08/2019 & 90/09/2019 – GST – Dated 18-2-2019)*

   CBIC has clarified that registered persons making inter-State supplies to unregistered persons shall report the details of such supplies **along with the place of supply** in Table 3.2 of Form GSTR-3B. Further, the details of all inter-

State supplies made to unregistered persons where the invoice value is up to ₹ 2.5 lakh (rate-wise) are required to be reported in Table-7B of Form GSTR-1.

Non-mentioning of the said information is resulting in

(i) non-apportionment of the due amount of IGST to the State where such supply takes place; and

(ii) a mis-match in the quantum of goods or services or both actually supplied in a State and the amount of integrated tax apportioned between the Centre and that State, and consequent non-compliance of sub-section (2) of section 17 of the Integrated Goods and Services Tax Act, 2017.

Furthermore, it is clarified that contraventions of above compliance may lead to penal provisions under CGST Act.

Furthermore, it has been brought to the notice of the Board that a number of registered persons (especially in the banking, insurance and telecom sectors, etc.), are not mentioning the place of supply along with the name of the State in case of a supply made in the course of inter-state trade or commerce in contravention of Rule 46(n) of the CGST Rules which mandates that the said details must be mentioned in a tax invoice. It is therefore, instructed that all registered persons making supply of goods or services or both in the course of inter-State trade or commerce shall specify the place of supply along with the name of the State in the tax invoice.

3. **Clarification in regard to tax payment made for supply of warehoused goods while being deposited in a customs bonded warehouse for the period July, 2017 to March, 2018** *(Circular No. 91/10/2019 – GST – Dated 18-2-2019)*

CBIC clarified that tax payment made for supply of warehoused goods while being in the custom bonded warehouse for the period July 2017 to March 2018 would be subject to integrated tax. It has been stated that due to technical issues in the portal the persons had to pay tax as CGST and SGST instead of IGST. So the department has provided one time exception to such persons who had paid CGST & SGST instead of IGST and it has been clarified there would not be any non-compliance on account of such tax payment.

C. CGST 'Removal of Difficulty Orders'

1. **Amend Removal of Difficulty Order No. 1/2017 dated 13-10-2017 so as to allow the supply of services to those persons who opt for composition scheme** *(Order No. 1/2019 – GST – Dated 1-2-2019)*

The Central Government, on recommendations of the Council, has issued order to amend Removal of Difficulty Order No. 1/2017 dated 13-10-2017 so as to allow the persons who opt for composition scheme u/s. 10 of CGST Act for the supply of services to the extent of 10% of turnover in a State or Union Territory or rupees five lakh whichever is higher.

2. **Amend Removal of Difficulty Order No. 4/2018 dated 13-12-2018 so as to extend the due date for furnishing of Form GSTR-8 for the period of October 2018 to December 2018.** *(Order No. 3/2019 – GST – Dated 1-2-2019)*

The Central Government, on recommendations of the Council, has issued order to amend Removal of Difficulty Order No. 4/2018 dated 13-12-2018 so as to extend the due date for furnishing of Form GSTR–8 for the period October 2018 to December 2018 till 7th February 2019.

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CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Writ Petition

1. Torrent Power Limited vs. Union of India – High Court of Gujarat (2019-TIOL-15-HC-AHM-GST)

Facts, issue involved and contention of petitioner

Petitioner is a public limited company, which is engaged in the business of generation, transmission and distribution of electricity in the State of Gujarat and is duly registered under the Goods and Services Act, 2017. As per Section 43(2) of the Electricity Act, 2003, it is the duty of the distribution licensee to provide electric plant or electric line for giving electric supply to the premises of the customer. An electric meter is also required to compute the actual consumption of electricity. The petitioner collects monthly meter rent of such meter in the bill for electricity consumption itself, as determined by the State Electricity Regulatory Commission (SERC).

Prior to the introduction of the Negative List regime for Service tax, the petitioners were of the belief that since there is no specific clause in the charging provision of the Finance Act requiring payment of service tax, no service tax was required to be paid in respect of any amount collected from the consumers. The Government of India issued **Notification No. 11/2010- Service Tax,** exempting taxable service provided to any person by any person for transmission of electricity. Another **Notification No. 32/2010- Service Tax** was issued exempting taxable service provided to any person by a distribution licensee/franchisee for distribution of electricity.

Department issued notices to the distribution/transmission companies imposing tax on various charges collected by such companies on the activities relating to transmission and distribution of electricity for the period prior to the issuance of the exemption Notifications 11/2010 and 32/2010. Many representations were made to Government to intervene and clarify the issue of related services of transmission and distribution of Electricity. Government, therefore, issued Circular dated 7-12-2010, wherein it clarified that supply of electricity meters for hire to the consumers was an essential activity having direct nexus with the transmission and distribution of electricity.

GST regime was introduced w.e.f. 1-7-2017. As per Notification No. 12/2017 – Central tax (rate), transmission or distribution of electricity is taxed at nil rate. The petitioners were of the view that the legal position under the Finance Act, 1994 was continued even under the Goods and Services Tax Act, 2017. Thereafter, the government issued the impugned **circular 38/2018** dated 1-3-2018, clarifying that the transmission and distribution by an electricity transmission or distribution utility is exempt from GST under Notification No. 12/2017 – CT(R). However, other services such as application fee for releasing connection of electricity, rental charges against metering equipment, testing fees for meters/ transformers, etc., are taxable.

The petitioner contended that all the charges such as application fee, meter rent, testing fee, etc. are towards the service of transmission and distribution of electricity which are covered by the negative list and by virtue of exemption notifications issued under the CGST Act, and therefore, all such services are exempt from payment of GST.

Alternatively, it was contended that if the services relating to transmission and distribution of electricity are *per se* not covered by the exemption notifications, then such services would form part of composite supply of services of the petitioners involving more than one supply. Therefore by virtue of provisions of Section 8 (a) of the CGST/SGST Acts, it would be treated as a supply of the **principal supply**, namely, transmission and distribution of electricity and taxed accordingly.

Observations of HC

Service tax circular dated 7-12-2010 stated that supply of electricity meters for hire to consumers is covered by the exemption notification as it is an essential activity having direct and close nexus with transmission and distribution of electricity.

The meaning of "transmission and distribution of electricity" does not change under the Negative List regime or the GST regime. Accordingly, services which stood included within the ambit of transmission and distribution of electricity during the pre-Negative List regime cannot now be sought to be excluded by merely issuing a clarificatory circular, that too, with retrospective effect. By the clarificatory circular, the respondents seek to give a different interpretation of the very same services as against the clarification issued for the pre-negative list regime.

Section 43(2) of the Electricity Act casts a duty upon the licensee to provide, if required, electric plant or electric line for giving electric supply to the premises. Therefore, providing electric line and electric plant are elements of service which are naturally bundled in the ordinary course of business, with the single service of transmission and distribution of electricity which gives the bundle its essential character. The only related service, which does not fall within the ambit of the definitions of electric line and electric plant, is the meter used for ascertaining the quantity of electricity supplied to any premises.

However, in so far as installation of electricity meter and hire charges collected in respect of electricity meters are concerned, service tax circular clarifies that supply of electricity meters for hire to the consumers is an essential activity having direct and close nexus with transmission and distribution of electricity. Therefore, it is covered under the exemption entry for transmission and distribution of electricity extended under the relevant notifications. Therefore, all the services related to transmission and distribution of electricity are naturally bundled in the ordinary course of business of the petitioner. They are required to be treated as provision of a single service of transmission and distribution of electricity, which gives the bundle its essential character.

Services provided by the petitioner are in the nature of composite supply and therefore, in view of the provisions of clause (a) of section 8 of the CGST Act, the tax liability has to be determined by treating such composite supply as a supply of the principal supply of transmission and distribution of electricity. Consequently, if the principal supply of transmission and distribution of electricity is exempt from levy of service tax, the tax liability of the related services shall be determined accordingly.

Held

Paragraph 4(1) of the impugned Circular No. 34/8/2018- GST dated 1-3-2018 is struck down as being ultra vires to the provisions of Section 8 of CGST Act as well as notification no. 12/2017 – Central tax (rate).

In other words, Hon'ble High Court held that application fees, meter rent, testing fees, etc. received by the electricity company is for transmission and distribution of electricity which is exempt from GST.

B. Rulings by Appellate Authority of Advance Ruling

2. M/s. Nutan Warehousing Company Private Limited – AAAR Maharashtra (2018-TIOL-25-AAAR-GST)

Facts, issue involved and contention of applicant

Applicant was engaged in the business of providing warehousing services and was registered under the GST Act. Applicant had constructed warehouses at various places, one of which situated at Fursungi, Pune and has rented it to M/s. Unilever India Exports Ltd. (hereinafter referred to as "Unilever"). Unilever procures tea of various qualities in bulk either from public tea auctions or directly from the manufacturers and stores in warehouse of applicant. The procured tea leaves undergo standard processes prior to procurement. However at no point of time, it crossed the limit and lost its essential characteristics. Unilever undertook blending and packing of the same at the warehouse after which they were exported overseas. The applicant is of the strong view that the tea procured is **an agricultural produce** as defined under **clause 2(d)** of the notification No. 12/2017-CT(R) dated 28-6-2017 and hence storage and warehousing of tea is exempt from GST.

Applicant seeks ruling on *"Whether the supply of warehouse services used for packing & storage of tea is exempted vide Serial No. 54(e) of notification no. 12/2017 CT (R)".*

Discussions by and observations of AAR

AAR studied the details of nature of goods being stored by Unilever. They also studied in detailed the process flow chart and steps. On its perusal, AAR was of the view that even if Unilever bought in raw tea leaves or semi-processed tea leaves, they are undertaking further processing and manufacturing. Such processed tea leaves are packed into Lipton Pure and Simple 100s tea bags. The activity of Unilever of processing raw tea leaves into tea results into emergence of new product having distinct name i.e., Tea, which has distinct name, character and use. As such the impugned activity is a 'manufacture' as defined u/s. 2(72) of CGST Act. Final product (Tea) cannot be considered as agricultural produce.

Ruling of AAR

AAR ruled that exemption stated in Notification No. 12/2017 – Central tax (Rate) will not apply in applicant's case.

Appeal to the AAAR and observations of AAAR

Aggrieved by the above-referred ruling, the applicant preferred an appeal to AAAR against the same. Applicant reiterated grounds stated in the application and further stated that blending and packing of tea leaves does not alter the essential characteristics of tea. None of the processes so carried out changes the originality of tea. Applicant was of the view that AAR has not provided any sufficient reasoning or explanation on whether these processes are changing the essential characteristics of tea or not.

The moot issue is to decide upon whether the tea leaves procured are agricultural produce or otherwise.

Firstly, AAAR set out to determine the essential character and the nature of the green tea leaves. The leaves plucked are not fit for human consumption and hence are processed to make it consumable. The manufacturers carry out the said processes after procuring the leaves and as a result, the tea leaves acquire new flavour and colour. Thus, the tea leaves are not acrid as in case of the original tea leaves directly packed from the garden. The nomenclature of tea also undergoes a change from green tea leaves to black tea. Unilever has stated that their sole ingredient is black tea, which are blended in specific proportions as per the order received from customers. Thus, it can be inferred that the product stored in the warehouse has a different name, character and uses from the green tea leaves cultivated in the garden. Thus, tea procured by Unilever is a manufactured product.

Secondly, it needs to be determined whether the manufactured product i.e., black tea is an agricultural produce or not. Following parameters are relevant:

a) The produce must emerge from cultivation of plants or rearing of all life forms of animals

b) Either no further processing is done or such processing is done as is usually done by a cultivator or producer, which does not alter its essential characteristics but make it marketable in primary market.

AAAR observed that though the product is produce out of cultivation of plants, the same is obtained as a result of specific manufacturing processes, carried out by the manufacturers on the original agriculture produce i.e., Green Tea Leaves for making them suitable for consumption by imparting desired flavours and colours by aforesaid activities. All these processes, which change the characteristics of green tea leaves, are carried out by the **manufacturers** and **not cultivators or producers** and thus cannot be considered as an agricultural produce.

Ruling of AAAR

AAAR did not find any reason to interfere with ruling given by AAR and dismissed the appeal filed by the applicant.

C. Rulings by Authority of Advance Rulings

3. M/s. Bindu Ventures – AAR Karnataka (2018-TIOL-294-AAR-GST)

Facts, issue involved and contention of the applicant

Applicant is engaged in the business of construction of commercial complexes. One such construction project was implemented at Karnataka in name of "Bindu Galaxy" in February 2016 and was completed in all aspects by the end of November 2017. The applicant obtained all the necessary approvals from various Government departments as required. The applicant stated that in Karnataka, the law provides for issuance of Occupancy Certificate (OC) from the Bruhat Bengaluru Mahanagara Palike (BBMP) and there is no provision for issuing the Completion Certificate (CC) on the construction of immovable property. For some reasons, applicant was unable to obtain the OC from BBMP. However, they have obtained CC from a chartered engineer, declaring that the construction was completed by 1-12-2017.

Applicant has sought advance ruling in respect of following questions:

i. *Which date should be considered as the date of completion of the property – the* *date of receipt of necessary approvals from BBMP / Karnataka Pollution Control Board / Karnataka Electricity Board or the date of receipt of CC from a registered Chartered Engineer?*

ii. *Whether the applicant is liable to pay GST on any amount received as consideration towards sale of completed offices, after the date of completion, where part of the consideration was received prior to date of completion as stated in (i) above?*

iii. *Whether the applicant is liable to pay GST on the consideration received towards the sale of completed offices, where the entire consideration is received after the date of completion as stated in question (i) above?*

Applicant's submissions based on Schedule II of CGST Act, 2017

Clause 5: Construction of complex, building, civil structure which is intended for sale to a buyer will be liable to GST **except when** the <u>entire consideration</u>, towards sale of immovable property, is received after issuance of <u>CC</u>, where required, by the Competent Authority or after its first occupation, whichever is earlier.

Explanation to clause 5: CC obtained from a registered Architect / Chartered Engineer/ Licensed Surveyor will be a **sufficient compliance** for the purpose of clause 5, only when there is no requirement under state law to obtain such certificate from a specific authority.

Therefore, applicant contends that date mentioned in CC received from Chartered Engineer should be taken as **Date of Completion** of construction for all purposes of GST law.

The applicant had filed an additional submission of an extract of Karnataka State local law for the reference which reads as follows:

"5.6 Occupancy Certificate

*5.6.1 (a) Every person shall before the expiry of five years from the date of issuance of licence shall complete the construction or reconstruction of a building for which the licence was obtained and within one month after the completion of erection of a building shall send intimation to the Commissioner in writing of such completion accompanied by a certificate in schedule VIII certified by a **Registered Architect / Engineer / Supervisor** and shall apply for permission to occupy the building…"*

Thus, according to the applicant, the BBMP provides a clear distinction between CC and OC and that it cannot be deemed to be a CC as contemplated under the GST Law.

Further, it submitted that phrase "First Occupation" may be understood (based on dictionary meaning) to mean the act of occupying or using the complex / building for first time by a person. Therefore, construction is deemed to have been completed, if any person has occupied a unit in the complex. Applicant claimed that occupation in "Bindu Galaxy" started in September 2017 and furnished copies of affidavits from respective owners and electricity bill for the period 4-8-2017 to 30-11-2017 in support of its claim of first occupation.

Discussions by and observations of AAR

AAR, w.r.t. about question (i) drew attention to Clause of 5 of Schedule II of CGST Act, 2017. The authority stresses on following words:

- **entire consideration;**
- **after the issuance of CC by the competent authority, where required;**
- **first occupation.**

The competent authority is defined in Sec 2(29) of the CGST Act, 2017 which means 'any such authority as may be notified by the Government' whereas Sec 2(80) of the CGST Act, provides for the meaning of the words "notified".

The crucial aspect, which decides the tax liability, is the date of ***completion certificate*** or ***first occupation***, whichever is earlier, issued by a competent authority.

The complete extract of bye-law 5.6 brings out that once the builder feels that the construction of the building is over, the builder shall first obtain a certificate from a registered architect / engineer to that effect and shall apply to the BBMP for occupancy permission. It further provides that the authority shall conduct physical inspection for various compliances, only after which, the OC shall be issued. This brings out that mere submission of a certificate from an engineer / architect does not certify the building to be complete. The law provides the submission of the certificate only as a **supportive document.**

The terms 'OC' and 'CC' become congruous to each other and only remain a matter of pedagogical difference. 'OC' issued means that the building has complied with all required bye-laws and is complete in all respects as its construction is concerned and can be occupied. **An OC is in the nature of CC** because unless the construction is complete, it cannot be occupied. Thus, AAR is of the opinion that the OC is akin to CC and is a must.

The building or part thereof can only be occupied after completion and necessary OC is obtained from BBMP. Thus, the fact that building is occupied does not mean it's complete. Therefore, the Chartered Engineer's certificate **cannot** be a substitute for **OC/CC** and the relevant date would be the **Date of OC**.

Ruling of AAR

In respect of question (i), the date of OC issued by the competent authority, i.e. BBMP should be treated as the date of completion of the construction.

In respect of question (ii), if any consideration is received before date of OC, then the transaction would be considered as the supply of services in terms of Clause 5 of Schedule II to the GST Acts, and liable for GST.

In respect of question (iii), if the whole consideration is received after the date of completion, then the transaction would not be liable to GST.

4. Asahi Kasei India Private Limited – AAR Maharashtra (2019-TIOL-14-AAR-GST)

Facts, issue involved and contention of the applicant

Applicant is a subsidiary of Asahi Kasei Corporation, Japan. The applicant provides sales promotion and marketing support to Asahi Kasei group. For this the applicant has entered into a Service Agreement with Asahi Japan and Marketing Services Agreement with various group companies of Asahi Kasei group. Broad scope of work as per the agreement is as under:

a. Collecting and analyzing information .i.e. market analysis and supporting Asahi Kasei group in getting new business;

b. Providing marketing & administration support and back- office support (including accounting Support);

c. Networking .i.e. co-ordinate with the government authorities and relevant universities to join relevant trade associations;

d. Supporting sales activity of Asahi Kasei group.

Applicant has sought advance ruling in respect of following questions:

i. Whether the service supplied by the applicant under the Service Agreement dated 1st March 2013 constitutes supply of "Support services" classifiable under HSN code 9985 or "Intermediary service' classifiable under HSN 9961/9962?

ii. Whether the service supplied by the applicant under the Marketing Services Agreement dated 1 December 2012 constitute supply of "Support Services" falling under HSN code 9985 or "Intermediary service" classifiable under HSN code 9961/9962?

iii. *Whether the services provided by the applicant is an export of services as defined under Section 2(6) of Integrated Goods and Services Tax Act 2017?*

Applicant's submissions

Term "intermediary" is defined as under Section 2(13) of the IGST Act, 2017 to mean *a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons but does not include a person who supplies such goods or services or both or securities on his own account.*

In the instant case the applicant and the Service recipient are acting as independent contractors. Moreover, the applicant and the Service recipient have no authority to create nor do they assume any obligation on behalf of the other. Also the agreement clearly specifies that parties do not intend to create any principal-agent relationship. Further, the consideration charged is not qua a particular transaction. Activities of sales promotion and marketing are not selling of goods and therefore, such activities would not be classifiable under the said heading of intermediary.

Applicant further relied on ruling of *M/s. GoDaddy India Web Services Pvt. Ltd. [2016 (46) STR 806 (AAR)]* wherein it was concluded that services (marketing, branding, offline marketing, overlooking third party customer care centre, etc.) provided by GoDaddy is a bundle of service (in normal course of business) and not intermediary services.

It is amply clear that the services provided by the applicant cannot be considered as an "Intermediary Services". However, in order to determine the correct classification of the services provided by the applicant, it would be imperative to refer to the scope of the term "Support Services".

Erstwhile Section 65B(49) of Finance Act, 1994 defines "support services" to mean *infrastructural, operational, administrative, logistic, marketing or any other support of any kind comprising functions that entities carry out in ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever ………………"*

From the stated definition, it can be construed that marketing services, advertisement and promotion services, customer relationship management, evaluation of prospective customers, etc. would qualify to be in the nature of support services. Thus, the supply of services that is to be provided by the applicant to the Asahi Kasei group would be classified under Tariff Entry 9985 as "Business Support Services".

In relation to "export of services", applicant was of the view that they are complying with all the conditions as prescribed under Section 2 (5) of IGST Act for treating supply of services as export of services.

Discussions by and observations of AAR

In order to determine whether a person is acting as an intermediary or not, following factors need to be considered:

a. Nature and value – An intermediary cannot alter nature or value of the service

b. Separation of value – Value of an intermediary's service is invariably identifiable from main supply of service

c. Identity and title – The service provided by intermediary on behalf of principal is clearly identifiable from main supply that he is arranging.

Normally, the intermediary has documentary evidence authorising him to act on behalf of the provider of the 'main service'. From the scrutiny of clause 15 of service Agreement, AAR confirmed that the relationship between the parties is that of independent contractors. Agreement does not intend to create relationship of principal and agent. Applying the test laid down in the Educational Guide to the facts of the case, we can safely conclude that the proposed service would not fall to be classified as 'intermediary service'.

Moving on further, one needs to decide whether the services supplied by applicant constitute composite supply and categorises as "support services". As per the definition of composite supply, it is necessary to determine whether a particular supply is naturally bundled in ordinary course of business and what constitutes a principal supply. Applicant proposes to provide broadly two distinct categories of services namely:

a. Research related services; and

b. Information on markets in the territory

From the nature of services provided it is evident that these services are not independent but could be provided as standalone services. One can say that applicant intends to provide two distinct category of services And as such services provided by this agreement can not constitute 'composite supply' as defined under the GST Act. Services provided by applicant in nature of research on the matter related to functioning of holding company would fall under Tariff Code 998599 – *"Other support services nowhere else classified"* and that in nature of information on market in territory would fall under tariff code 998371 – *"Market research services"*.

AAR was of the same view with regards to marketing services agreement that applicant is not an intermediary and acts in capacity of an independent contractor. Services provided by applicant under said agreement would fall under group 99837 as "Market Research Services".

Supplier of service is located in India; service recipient is located outside India - Japan; payments is received in convertible foreign exchange; supplier and recipient are not merely establishment of distinct person and applicant not being intermediary, place of supply would be location of recipient of services i.e. Japan which is outside India. All the conditions as to export of services are being satisfied in the given case.

Ruling of AAR

In respect of the question (i), the services provided in the nature of Research would fall under the service Tariff Code 99859 as other support services. The services provided in nature of information on market would fall under the service Tariff Code 99837.

In relation to question (ii), the services provided under Marketing Services Agreement would fall under 99837.

In relation to question (iii), AAR ruled that services provided by applicant would qualify as export of services.

5. M/s. Nforce Infrastructure India Private Limited – AAR Karnataka (2018-TIOL-290-AAR-GST)

Facts, issue involved and contention of the applicant

The applicant, M/s. Nforce Infrastructure India Pvt. Ltd., entered into an agreement with land owners for construction project and in turn has agreed to hand over 8,828 square feet of residential apartment area, 1,630 square feet of commercial area and 8 car parkings to the land owner.

Applicant has sought advance ruling in respect of following questions:

i. *Whether the applicant is liable to pay GST on the value of building constructed and handed over to the land owner in terms of the Joint Development Agreement?*

ii. *If yes, then, on what value GST is to be paid since there is no monetary consideration involved?*

iii. *Is the applicant liable to pay service tax up to 30-6-2017 and GST thereafter?*

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Discussions by and observation of AAR

Notification No. 4/2018- Central Tax (Rate) dated 25-1-2018, **notifies the registered persons** who supply construction service to supplier of development rights against consideration in the form of transfer of development rights, **as the registered persons** liable to pay central tax on supply of said services, on the consideration received in the form of development rights. The liability to pay tax shall arise at the time when the said developer **transfers possession or the right in the constructed complex, building or civil structure,** to the person supplying the development rights by entering into conveyance deed or similar instrument.

In the instant case the applicant, a registered person, needs to pay tax towards construction service provided to the land owner, on the value to be determined in terms of **Para 2 of the Notification No. 11/2017- Central Tax (Rate)** dated 28-6-2017, which is appended as under:

In case of supply of service specified in column (3) of the entry at item (i) against serial no. 3 of the table above, involving transfer of property in land or undivided share of land, as the case may be, the value of supply of service and goods portion in such supply shall be ***equivalent to the total amount charged for such supply less the value of land*** *or undivided share of land, as the case maybe, in such supply shall be* ***deemed to be one third of the total amount charged for such supply.***

For the purpose of paragraph 2, "total amount" means the sum total of:-

a) Consideration charged for aforesaid service; and

b) Amount charged for transfer of land or undivided share of land, as the case may be

Further, attention is to be drawn to Section 142 (11)(b) of CGST/ KGST Act 2017, which is appended below:

(b) notwithstanding anything contained in Section 13, no tax shall be payable on services under this Act to the extent the tax was leviable on the said services under Chapter V of the Finance Act, 1994;

It is clearly evident from Section 142(11)(b) that the service tax is liable to be paid, which is leviable under the Finance Act, 1994, on the services up to 30-6-2017, on the services provided after 1-7-2017. Therefore, AAR was of the opinion that the applicant has to pay service tax/GST proportionate to the services provided before/after 30-6-2017 respectively.

Ruling of AAR

In respect of question (i), the applicant is liable to pay GST on the value of building constructed and handed over to the land owner in terms of the Joint Development Agreement.

In respect of question (ii), the value on which the applicant is liable to pay GST is to be determined in terms of para 2 of notification No. 11/2017- Central Tax (Rate) dated 28-6-2017.

In respect of question (iii), the applicant is liable to pay service tax/ GST proportionate to the services provided before/after 30-6-2017 respectively.

6. POSCO India Pune Processing Centre Private Limited – AAR Maharashtra (2018-TIOL-25-AAR-GST)

Facts, issue involved and contention of the applicant

Applicant is a South Korea based company and primarily engaged in distribution of steel coils. It also undertakes low value-added processing of traded goods based on the requirement of the customers. Applicant is paying GST on reverse charge basis under import of services, transport of goods by road, legal services, etc.

As per POSCO group policy, key personnel such as Managing Director (MD) and General Manager (GM) are deputed to the Indian

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POSCO group companies. The key personnel are provided rent-free accommodation in hotel and the cost is borne by the applicant.

Applicant has imported certain goods from POSCO Daewoo Corporation, Korea. Upon receipt of said goods, the applicant availed Input Tax Credit of IGST. Applicant eventually sold the goods to the customer on payment of GST. Subsequent to the sale, it was observed that said goods were defective and did not meet customer requirements. Therefore the applicant raised a credit note on the customer. As per the agreement with POSCO Korea, applicant is supposed to charge back the loss to the parent company and for this applicant is required to raise tax invoice on POSCO Korea.

It is the practice of the applicant to provide Mediclaim cover to the employees as well as to their parents. In case of Parent Insurance facility, the applicant initially pays the entire premium along with taxes and then 50% is recovered from respective employees on a monthly basis.

Applicant has sought advance ruling in respect of following questions:

i. *Whether Input Tax Credit is admissible in respect of GST paid for hotel stay in case of rent free hotel accommodation provided to GM and MD of the Applicant?*

ii. *Whether invoice for quality claim raised by the applicant in POSCO Daewoo Corporation located in Korea will be treated as "export of services"?*

iii. *Whether recovery of Parent Health Insurance expenses from employee in respect of insurance provided by the applicant amounts to "supply of services" under Section 7 of Central Goods and Services Tax Act, 2017?*

iv. *If the said recovery amounts to "supply", what will be the time of supply and value of supply? Whether the applicant can claim input tax credit of GST charged by the insurance company?*

Applicant's submissions

As per Section 16(1) of the CGST Act, 2017, every registered person shall be entitled to take Input Tax Credit on any supply on any supply of goods or services or both to him which are used or intended to be used **in the course of business**. In the present case, as per the policy the MD and GM are deputed to India considering the business requirement and smooth functioning of business. Moreover, providing rent-free accommodation is generally accepted business practice across most of the business in India. Also Income Tax Department has allowed the said expenditure (as part of salary) as a business expenditure. If the MD and GM have been on business trips to India such expenditure should have been considered to be in the course of business. Therefore, GST paid such hotel expenses should be allowed as input tax credit under Section 16(1) of the Act.

As per the agreement, applicant is to recover the loss (i.e., loss incurred due to defective imported goods) by raising tax invoice on POSCO Korea. "Export of services" is defined u/s. 2(6) of IGST Act and requires fulfilment of certain conditions. Applicant is of the view that the above service classified under "agreeing to the obligation to tolerate an act or a situation will qualify as 'export of service' since all the conditions of Section 2(6) are satisfied.

As per Company policy, applicant recovers 50% of insurance premium amount from its employees. As per Schedule III of CGST Act, 2017, services by an employee to employer in the course of or in relation to his employment are not treated as a supply of service. However, if employer provides any services, the same will be considered as supply of services. As per Section 15(5)(a)(iii) of CGST Act, 2017, employer are treated as "related persons" and hence, valuation of the supply needs to be determined as per **Rule 28** of CGST Act.

As per the above stated rule, *the value of supply shall be the* ***open market value*** *of such supply OR* *value of supply of services of like kind and quality OR value determined by rule 30 or rule 31, **in the order.***

Based on the above rule, the applicant is of the view that GST should be levied on the entire amount of premium paid by the applicant and not just premium amount recovered from its employees.

Discussions by and observations of AAR

In accordance with Section 16 of CGST Act, ITC is available on the tax charged on any supply of goods or services or both to the applicant, which are used or intended to be used in the course or furtherance of business. As per Section 17(5)(g) of CGST Act, ITC shall not be available **on goods or services or both used for personal consumption.** AAR observed that providing residential accommodation is not in furtherance of business. MD/GM could have been provided with any other residential accommodation and still could have performed their duties for the applicant. In case of residential accommodation, GST is not liable to be paid on rent received. If MD / GM were residing at any residential place or society, they would have only paid rent without GST. In view of the above discussions, AAR held that ITC cannot be claimed by the applicant.

With regards to the goods imported, defects were only noticed after the goods were sold to the customer. Till then credit had already been taken on such imported goods. It is not known as to what happens to the defective goods, whether the same is returned back to the applicant or not. At the time of receipt of goods no defect seems to have been noticed by the applicant and therefore there is no reason for them to tolerate any act. Further, defect has been noticed by customer and therefore it is the customer who is tolerating the act of having sent defective goods. In respect of the so-called defective goods, applicant has failed to state whether the goods are sold as such to their clients or whether the goods were sold to their customer after they have carried out low value-added processing function. AAR refrained from answering second question as complete details was not submitted by the applicant.

Applicant pays premium upfront and recovers 50% of the premium amount from employees. There is no way that 50% amount recovered can be treated as amounts received for services rendered. Such recovery of 50% premium amount cannot be termed as supply of services under GST laws. In fact, what is happening that since applicant is recovering 50% of premium paid and they want to treat same as output services and claim full ITC on insurance premium paid to insurance company in terms of Section 17(5)(b)(iii) of CGST Act. It appears that applicant is creating fiction of providing health insurance services to employees in order to avail 100% ITC of insurance premium expenses. Hence they are not rendering any services of health insurance to their employees and there is no supply in this case.

Ruling of AAR

In respect of the question (i), ITC is not admissible in respect of GST paid for hotel stay.

In respect of the question (ii), AAR refrained from answering because of incomplete details.

In respect of the question (iii), the recovery of parents health insurance expenses from employee does not amount to "supply of service" under the GST laws.

In respect of question (iv), since there is no supply of services there is no question of time and value of supply. Applicant cannot claim ITC of the GST charged by the insurance company.

7. Storm Communications Private Limited – AAR West Bengal (2019-TIOL-15-AAR-GST)

Facts, issue involved and contention of the applicant

Applicant is a supplier of Event Management Services who organises events on behalf of clients. For this purpose, they book conference halls, banquet halls, outdoor caterers etc.

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The applicant is registered in West Bengal, Jharkhand, Odisha, Maharashtra and Delhi.

In relation to their event management services, applicant needs to move to other States (where he is not registered), to cater the clients. They incur various miscellaneous expenses in such States for booking hotels, banquet halls and on food. Applicant is charged local CGST & SGST of that particular state (where he is not registered) on such inward supplies. Local vendors issue B2B invoices with the applicant's GSTIN and such invoices appear in GSTR 2A of the applicant.

Applicant has sought advance ruling in respect of following questions:

i. *Can a person, registered in West Bengal, claim ITC for CGST and SGST of other states?*

ii. *Can he adjust the ITC of one state's CGST for payment of another State's CGST?*

iii. *Can he adjust the ITC of Tamil Nadu GST for payment of IGST, whereas he is not registered in Tamil Nadu?*

Discussions by and observations of AAR

GST is a destination based consumption tax. Tax is levied where goods and services are consumed and revenue accrues to that particular State. Under GST, there are three levels of tax, IGST, CGST & SGST and based on the "place of supply" so determined, the respective tax will be levied. "Place of Supply" is determined by location of the supplier and the recipient. Place of Supply has been defined in Chapter V of the IGST Act, 2017.

Applicant is registered in West Bengal and is charged local CGST and SGST (on hotel booking, banquet booking, food expenses, etc.) in the States where he is not registered.

In terms of Section 12(3) & (4) of the IGST Act, 2017, the place of supply will be the location of the hotel, banquet hall or restaurant, where the services are actually performed (in this case, Tamil Nadu). Hence, the suppliers of Tamil Nadu have rightly charged CGST & SGST on the invoices, since all the transactions are intra-state. The applicant on the contrary can avail ITC on the said invoices only if registered in Tamil Nadu.

Section 49(4) of the GST Act states that the amount available in the electronic credit ledger [Section 2(46)] may be used for settlement of outward tax liability. As per section 2(62) of the GST Act, 'Input Tax' means CGST, SGST and IGST charged on any supply of goods or services to the registered person. Input tax and its credit are linked with whether the person is registered or not, however, its availment is subject to registration in the state of consumption of supply. In this case, credit can be availed only if registration is taken in Tamil Nadu under section 25(1) of the GST Act after which it is regarded as "distinct person" as per section 25(4) of the GST Act. The architecture of the GST Act is such that if the applicant is not registered in a particular state, the tax paid on the inward supplies in that state is not 'input tax' in relation to the said person. As the applicant is not registered under section 25(1) in Tamil Nadu, the SGST and CGST paid on intra-state inward supply in Tamil Nadu are not 'input tax' to the said person. The GST Act does not contain any concept of 'input tax' to an unregistered person. No credit of it is, therefore, admissible under the GST Act.

Ruling of AAR

In respect of question (i), a person registered in West Bengal, cannot claim ITC for CGST & SGST of other States.

In respect of question (ii), the applicant cannot adjust the ITC of one State's CGST for payment of another State's CGST.

In respect of question (iii), the applicant cannot adjust the ITC of Tamil Nadu GST for payment of IGST, whereas he is not registered in Tamil Nadu.

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CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018- TIOL-2409-HC-DELHI

Case: CST, Ahmedabad vs. M/s. Vodafone Mobile Services Ltd., & M/s. Indus Towers Ltd. & Others vs. CST, New Delhi and Others

Background facts of the case

The appellant Indus, and the assessee respondent Vodafone, provide cellular telephone services and pay service tax applicable on cellular telephone services. They have availed CENVAT credit of the excise duty paid on towers, parts and shelters/pre-fabricated buildings purchased by it and thereby used to provide output service. SCN's were issued *inter alia*, alleging that they had wrongly claimed and utilised CENVAT credit in contravention of the provisions of Rule 2(a)(A) of CCR, 2004. The present cases are before the HC for the following questions of law and the verdict passed by the LB of Delhi CESTAT in case of the appellant *M/s. Indus Towers Ltd. and Ors 2016-TIOL-539-CESTAT-Del-LB:*

a) Whether the CESTAT was right in concluding that the towers, shelter and accessories used by the appellants for providing telecom services are immovable property?

b) Whether the appellants are entitled to claim CENVAT credit on the towers, shelter as 'accessories' either as capital goods or input goods in terms of Rule 2(a) or 2(k) of the Credit Rules?

c) Whether the CESTAT erred in applying nexus test with reference to MS Angles and Channels, whereas according to the appellants what were brought to the site were towers, shelter and accessories for providing services?

d) Whether the appellants were justified, in terms of Rule 4 (1) of the Credit Rules, in claiming CENVAT credit of excise duty paid by the manufacturer of towers and shelters after receipt of such towers and shelters at their premises (i.e., tower sites)?

e) Whether the emergence of immovable structure at an intermediate stage (assuming without admitting) is a criterion for denial of CENVAT credit

Observations of the High Court

i) The primary question is whether the decision taken by the Tribunal that towers, parts thereof used for providing output services are immovable property or not. In this regard, it would be useful to refer to the relevant statutory provisions to examine, what would constitute as movable or immovable property. The expression "movable property" has been defined in Section 3(36) of the General Clauses Act, 1897 as under:

"Section 3(36): "Movable property" shall mean property of every description, except immovable property."

ii) It is obvious that the answer to the question whether the towers and shelters are movable would depend upon whether they are immovable property or not as per the definition.

iii) That apart from these findings of fact made by the Tribunal, the point advanced on behalf of the appellant, that whatever is embedded in earth must be treated as immovable property is basically not sound. For example, a factory owner or a householder may purchase a water pump and fix it on a cement base for operational efficiency and also for security. That will not make the water pump an item of immovable property. Some of the components of the water pump may even be assembled on site. That too will not make any difference to the principle. In view of that finding, we are unable to uphold the contention of the appellant that the machine must be treated as a part of the immovable property of the Company. Just because a plant and machinery are fixed in the earth for better functioning, it does not automatically become an immovable property."

iv) In view of this court, in the facts of the present case, the permanency test has to be applied, in the context of various objective factors and cannot be confined or pigeon holed to one single test. In the present case, the entire tower and shelter is fabricated in the factories of the respective manufacturers and these are supplied in CKD condition. They are merely fastened to the civil foundation to make it wobble free and ensure stability. They can be unbolted and reassembled without any damage in a new location. The detailed affidavit filed by the assessee demonstrates that installation or assembly of towers and shelters is based on a rudimentary "screwdriver" technology. They can be bolted and unbolted, assembled and re-assembled, located and re-located without any damage and the fastening to the earth is only to provide stability and make them wobble and vibration free; devoid of intent to annex it to the earth permanently for the beneficial enjoyment of the land of the owner. The assessees have also placed on record the copies of the leave and licence agreements, making it clear that the licensee has the right to add or remove the aforesaid appliances, apparatus, equipment etc.

v) On an application of the above tests to the cases at hand, this court sees no difficulty in holding that the manufacture of the plants in question do not constitute annexation and hence cannot be termed as immovable property for the following reasons:

(i) The plants in question are not *per se* immovable property.

(ii) Such plants cannot be said to be "attached to the earth" within the meaning of that expression as defined in Section 3 of the Transfer of Property Act.

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(iii) The fixing of the plants to a foundation is meant only to give stability to the plant and keep its operation vibration free.

vi) The Tribunal had denied CENVAT credit to the assessee on the premise that the towers erected result into an immovable property, which is erroneous and contrary to the judgment of the Supreme Court in the case of Solid and Correct Engineering. The towers which are received in CKD condition are assembled/ erected at the site subsequently giving rise to a structure that remains immovable till its use because of safety, stability and commercial reasons of use. The entitlement of CENVAT credit is to be determined at the time of receipt of goods. The fact that such goods are later on fixed/fastened to the earth for use would not make them a non-excisable commodity when received. Therefore, this question is answered in favour of the assessee and against the Revenue.

Citation: 2018-TIOL-3826-CESTAT-MUM

Case : Rohan Builders India Pvt. Ltd. vs. Commissioner of Central Excise and Service Tax, Pune-I

Background facts of the case

The department has conducted EA Audit-2000 and observed availment of inadmissible CENVAT credit of service tax paid on various services like security services, vehicle repair services and mobile phone bill payments of employees during the impugned period. Further it was also observed that the appellant had not paid the invoice value and also taken the CENVAT credit in respect of the tax component. Several other discrepancies were found out in the departmental audit. The Appellant on being informed about the same proactively reversed the CENVAT credit and also discharged the reverse charge liability along with the applicable interest and informed the departmental authorities of all the details. Despite this SCN was issued to the appellant for levy of penalty u/s. 78.

Arguments put forth

The counsel for the appellant submitted the following:

i) The allegation of suppression of facts mentioned in the SCN was unwarranted since the credit was availed in *bona fide* belief that they were eligible for the same. When being pointed out, the appellant accepted the liability and immediately reversed the entire CENVAT and paid the liability along with interest.

ii) It was one of the largest taxpayers in that Commissionerate and also prompt payer and thus non-payment of small amounts should not be viewed as suppression. Also, the availment of CENVAT against payment is of less significance since the same does not related to inadmissible credit but due to time lag of payment of the amounts and availment of credit.

iii) There was no *mens rea* on the part of the assessee as the transactions were reflected in the books of account of the assessee which had already been produced in front of the department. It was also argued that the penalty if imposed u/s. 78 must be restricted to 15%.

Decision

i) There is no mechanism for determining the admissibility of CENVAT credit in the self-assessment era for which the EA-2000 Audit has assumed its importance. The purpose of audit is to ensure reasonably that no amount which under the excise law is chargeable as duty, escaped taxation. It is a participative form of audit where the process is carried out in presence of the assessee and the matters are discussed and the assessee is advised on matters to follow correct procedure in future. Both CERA and EA 2000 are therefore held to be a participative form of audit. Therefore, it cannot be said that only because the audit party had found non-observance of partial reverse charge mechanism procedure in respect of certain services, without any reference to the service provider, the appellant can't be tested for suppression.

ii) Further, the basic purpose of audit is to detect any irregularity which might have gone unnoticed by the assessee and which should be reversed. Since, all the records are presented to the audit party there cannot be allegation of fraud, or suppression of material facts. This was held by Hon'ble Apex Court in the case of *Uniworth Textiles Ltd. (2013) TIOL 13*.

iii) In view of the above observation of the Hon'ble SC and having regard to the fact that such irregularity was found in EA audit vis-a-vis prompt payment of service tax and subsequent payment of penalty in conformity to section 78(B), They were of the view that confirmation of penalty under section 78 is uncalled for. The appeal was allowed and order passed by the Commissioner (Appeals) was set aside.

Citation: 2019-VIL-115-CESTAT-CHE-ST

Case: Hindustan Oil Exploration Co. Ltd. vs. Commissioner of GST & Central Excise, Chennai

Background facts of the case

The appellant is a private company engaged in exploration of oil and gas onshore and offshore in India and elsewhere and to tap oil and gas reserves and other similar or allied substances. For performing the petroleum operations, the appellants entered into contract for provision of manpower, hire of equipment contracts, consultancy contracts, material contracts and other service contracts with various companies who are experts in the field some located in India and mostly located abroad and appellants are receiving various input services from the persons/ companies based abroad who have no office in India.

During the course of audit conducted by the officers of internal audit, It was noticed that the appellants have not paid the service tax on the gross amount but on the TDS amount paid by grossing up.

Arguments put forth

The appellants submitted as under:

a) It was explained that contracts wherein all the indirect taxes is to be borne by the appellant, the appellant does not deduct TDS from the amount paid but pays the deductions to the Government from their own pocket and treats them as expenses. Since the said TDS is borne by the appellant, the demand of service tax on such amount cannot sustain.

b) The service tax department has been demanding service tax on the gross amount charged by the contractor as well as the TDS paid by the company in relation to the contract value but not charged by the service provider. It is clarified that TDS in such cases is not something which is charged by the service provider

c) The case of *M/s. Magarpatta Township Development & Construction Co. Ltd. vs.*

Commissioner of Central Excise, Pune – 2016 (43) STR 132 (Tri. Mum.) was also relied upon

The Respondents submitted as under:

a) The value of TDS should be included in the value of services provided by the foreign companies.

Decision

a) The appellant has furnished documents to show that though TDS amount is deposited, the same is borne by the appellant and has not been made part of the consideration. They have not deducted TDS but in fact have discharged the TDS liability. The appellant has borne the same as expenses of their company.

b) It was also observed that the issue is covered by the decision relied upon by the learned counsel in the case of Magarpatta Township Development & Construction Co. Ltd.

Accordingly the appeal filed by the assessee was allowed and the demand was dropped.

Citation: 2019-VIL-126-CESTAT-AHM-ST

Case: Ultratech Cement Limited vs. CCE Kutch (Gandhidham)

Background facts of the case

The brief facts leading to the dispute is that the appellants are engaged in manufacture of cement. The cement is directly dispatched to the customers from the factory or to the Depot and they are availing services of Goods Transport Agency for transportation of cement. The appellants were issued show cause notice for the period 2009-10 to 2013-14 proposing to deny CENVAT credit availed on service tax paid on outward transportation.

Arguments put forth

The assessee as appellants submitted as under:

a) In the facts of this case, the goods are cleared on FOR basis and all the expenses up to delivery of goods including damage to the goods and transportation uptil the buyer's doorstep is borne by the Appellant. The price charged to the customer is inclusive of freight and insurance charges. Hence the credit of service tax paid on freight amount is available to them.

b) The Board Circular No. 1065/4/2018-CX dt. 8-6-2018 was also relied upon, wherein the CBEC has viewed that the "place of removal" is required to be determined with reference to "point of sale". That in the present case since the liability of freight and damages to goods uptil doorstep of buyers is of appellants, the point of sale is that where the ownership of the goods changed hands i.e., doorstep of buyers.

c) It was alternatively submitted that the CENVAT Credit availed by the appellant on the outward transport charges cannot be recovered as the appellants have already discharged higher duty amount on the said services. Since, the service charges was included in the assessable value of the final product cleared on payment of duty

The Respondent submitted as under:

a) It was submitted that the Hon'ble Apex Court in the case of *CCE vs. Ultratech Cement Ltd. 2018 (9) GSTL 337 (SC)* has held that the CENVAT credit on GTA Service availed for transport from place of removal to buyers premises is not admissible.

b) In terms of Section 4(3)(c) of the Central Excise Act, 'place of removal' means factory or any other place or premises of production or manufacture of the excisable goods; warehouse or any other place or premises wherein the excisable goods have been permitted to be stored without payment of duty; depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory; from where such goods are removed".

c) Also as per Board's circular Nos. 37B order No. 59/1/2003 dt. 3-3-2003 and No. 97/8/2007 dt. 23-8-2007 stated that the place where the sale takes place, is the place of removal. Further CBEC *vide* Circular No. 988/12/2014 –CX dt. 20-10-2014 has stated that the place where the sales take place is the place where the transfer in property of goods takes place from seller to buyer. He held that the appellant has not produced any evidence showing the details such as name of depot/ dumpyard, quantity/ value of goods sent to their depots/ dumpyard and credit involved therein.

Decision

a) The appellants have annexed copies of excise invoice-cum-gate pass which shows that the prices are inclusive of freight and insurance and nothing extra has been charged. The goods are being cleared on FOR basis and all liabilities in respect of transportation of goods or damage to goods were on account of appellants. They were liable for safe delivery of goods up to their customer's doorstep. In such case when the sale of the goods is completed at the doorstep of the Customer or depot/ stockist as the case may be the point of sale.

b) Further the Chartered/ Cost Accountant has certified that the goods were sold on FOR basis by the appellant and the freight/ damages in transit was responsibility of Appellant till the goods reaches the doorstep of the Customers. Also we find that the consignment notes were raised upon the appellant and they did not charge any amount except price of the goods from the customers. Thus in the light of above circular we find that as the ownership of the goods remained with the Appellants till the goods reached to the customer's doorstep and the freight charges as well as damage (insurance) to the goods till destination were borne by the appellant, they are eligible for the credit of service tax paid by them on outward freight.

Accordingly the appeal filed by the appellants was allowed.

Citation: 2019-VIL-127-CESTAT-CHE-ST

Case: Sundaram Finance Limited vs. Commissioner of GST, Central Excise, Chhenai

Background facts of the case

The appellants are engaged in financing purchase of commercial vehicles, cars, houses, etc. It appeared to the Department that the appellants while calculating the proportionate credit attributable to exempted services had not adopted the correct value by not considering 90% of the value of service which was abated in terms of Notification No. 04/2006 dated 1-3-2006.

Arguments put forth

The appellants submitted as under:

a) Exempted services means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under Section 66 of the Finance Act. For Financial Leasing Services under Section 65(105) (zm), service tax is payable on a part of the value of such services and only 90% is exempted as per Notification No. 04/2006. Since service tax is payable on 10% of the value, it cannot be said that the services are wholly exempt from payment of service tax

b) The said issue has been analysed by the Tribunal in the appellant's own case *vide* Final Order Nos. 42221-42222/2018 dated 10-8-2018.

The respondent submitted as under:

a) Exempted services under Rule 2(e) of the CCR, 2004 is defined to consider that in the particular case, the service tax was exempted on 90% of the gross value and hence, the taxable service carried out by the appellants were exempted from the whole of service tax leviable thereon up to 90% of the gross value.

b) The appellants had paid service tax only on 10% of the gross value; that however for the purpose of working out proportionate credit on exempted services, they adopted the entire gross income from the said services including the exempted value, the value of taxable services under factor "F" in the prescribed formula, however excluding the very same amount from the value of exempted services under factor "E", namely, the numerator. Learned AR submitted that the formula does not provide a 'pick-and-choose' proposition by the appellants; that there has to be consistency followed by the appellant in the manner of inclusion or non-inclusion of the said value.

Decision

a) By virtue of the notification, service tax is required to be paid on a value equal to 10% of the total amount representing interest; balance 90% thus enjoys exemption from payment of service tax. The Show Cause Notice has been issued alleging that the appellant has to consider the 90% which enjoys exemption from payment of service tax as exempted services and include this value for arriving at the amount that has to be reversed. The definition of "exempted services" during the relevant period is reproduced below:

"*'Exempted services' means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under Section 66 of the Finance Act."*

b) Since service tax is payable on 10% of the value, it cannot be said that the services are wholly exempt from payment of service tax.

Accordingly the appeal filed by the appellants was allowed.

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Shri Ramakrishna uses to say, "As Long as I Live, so long do I learn".

That man or that society which has nothing to learn is already in the jaws of death.

— *Swami Vivekananda*

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 Circulars, Notifications and FAQs issued by RBI. In addition we have discussed few recent compounding orders issued by RBI.

A. Amendment to FEMA through A. P. Dir Circular issued by RBI

I) External Commercial Borrowings (ECB) Policy – ECB facility for Resolution Applicants under Corporate Insolvency Resolution Process (RBI/2018-19/121 – A.P. (DIR Series) Circular No. 18 dated February 07, 2019)

In terms of recent A.P. (DIR Series) Circular No. 17 dated January, 16, 2019 issued by RBI on "External Commercial Borrowings (ECB) Policy – New ECB Framework", ECB proceeds are not allowed to be utilised for repayment of domestic rupee loans, except when the ECB is availed from a Foreign Equity Holder as defined in the framework.

On a review, end-use restrictions have been relaxed by the RBI for resolution applicants under the Corporate Insolvency Resolution Process (CIRP) and allowed them to raise ECBs from all categories of the recognised lenders, except the branches/overseas subsidiaries of Indian banks, for repayment of rupee term loans of the target company under the approval route.

Accordingly the resolution applicants, who are otherwise eligible borrowers, can forward such proposals to raise ECBs to the Reserve Bank for approval.

Source: A.P. Dir. Series Circular No. 18 dated February 7, 2019.

(Comments: This is a pragmatic move by RBI as applicants of the target company under Corporate Insolvency Resolution Process (CIRP) can now raise ECBs from the overseas recognised lenders, except branches/overseas subsidiaries of Indian banks. This could help applicants looking to raise resources abroad for settlement with creditors, mostly bankers. This may also expedite the resolution process)

II) Investment by Foreign Portfolio Investors (FPI) in Debt (RBI/2018-19/123 – A.P. (DIR Series) Circular No. 19 dated February 15, 2019)

In terms of Schedule-5 to Notification No. 20(R) "Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017" exposure of Foreign Portfolio Investor (FPI) to corporate bond portfolio of a single corporate (including exposure to entities related to the corporate) is restricted to 20% of its overall corporate bond portfolio.

Such a restriction gave less access to the FPIs in the Indian corporate debt market. Hence, to encourage a wider spectrum of investors to access the Indian corporate debt market, the restriction is with immediate effect.

Source: A.P. Dir. Series Circular No. 19 dated February 15, 2019.

(Comment: This move is aimed at increasing liquidity for corporate debts that are starving for funds due to recent liquidity crisis reported by some of the largest NBFCs in India due to credit mismatch. The relaxation will allow FPIs to have larger exposure to a single corporate/ group also resulting into much needed liquidity in the system.)

III) Establishment of Branch Office (BO) / Liaison Office (LO) / Project Office (PO) or any other place of business in India by foreign entities (RBI/2018-19/132 – A. P. (DIR Series) – Circular No. 20 dated February 27, 2019)

In terms of the current extant regulations for BO/LO/PO contained under **Notification No. 22(R) – "Foreign Exchange Management (Establishment in India of a Branch Office or a Liaison Office or a Project Office or any Other Place of Business) Regulations, 2016"**, Non-Government Organisation, Non-Profit Organization, Body/Agency/ Department of a foreign Government require prior approval of RBI for opening of a branch office or a liaison office or a project office or any other place of business in India. RBI considers such applications in consultation with the Government of India.

However, Regulation 5-d of the Notification provides that if such applicant entity is engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA) and obtains a certificate of registration under the said Act, it is not required to seek permission / approval from RBI.

Accordingly, Form FNC has been suitably modified and the following phrase added under the heading 'Declaration' in Part II clause (ii), at the end of the existing sentence:

"We will not undertake either partly or fully, any activity that is covered under Foreign Contribution Regulation Act, 2010 (FCRA) and we understand that any misrepresentation made or false information furnished by us in this behalf would render the approval granted under the Foreign Exchange Management (Establishment in India of a branch office or liaison office or a project office or any other place of business) Regulations, 2016, automatically as void ab initio and such approval by the Reserve Bank shall stand withdrawn without any further notice".

Source: A.P. Dir. Series Circular No. 20 dated February 27, 2019.

(Comment: This is a welcome move aimed to ease branch/office setup procedures for several International NGOs engaged in humanitarian activities in India who are not seeking any foreign funds and hence not required to be registered under FCRA Act, 2010.)

B. Amendment to FEMA Notification No. 6(R)/(1)/2019-RB – Relaxation in carrying rupee notes to Nepal or Bhutan.

The existing provisions have been relaxed by amending existing sub-regulation 1 of Regulation 8. The amendment is as under:

"Take or send out of India to Nepal or Bhutan, currency notes of Government of India and Reserve Bank of India notes (other than notes of denominations of above ₹ 100 in either case), provided that an individual travelling from India to Nepal or Bhutan can carry ***Reserve Bank of India notes of Mahatma Gandhi (new) Series***

***of denominations ₹ 200/- and/or ₹ 500/-** up to a total limit of ₹ 25,000."*

C. Updated in FAQs

I) Liberalised Remittance Scheme (LRS)

RBI update on FAQs on LRS as on February 13, 2019 contains the following changes:

Answer to Questions 7 and 19 has been amended

Q.7 Is it mandatory for resident individuals to have Permanent Account Number (PAN) for sending outward remittances under the Scheme?

Ans. Yes. It is mandatory for the resident individual to provide his/her Permanent Account Number (PAN) for all transactions under LRS made through Authorized Persons.

Q.19 What are the documents required for withdrawal/remittance of foreign exchange for purposes mentioned in para 1 of Schedule III to FEM (CAT) Amendment Rules, 2015?

Ans. Permanent Account Number (PAN) is mandatory for all transactions under LRS.

II) Overseas Direct Investment

RBI update on FAQs on ODI as on February 28, 2019 contains the following changes:

Answer to Questions 1 and 5 have been redrafted

Q.1 Where are the guidelines pertaining to overseas direct investments available and how to get clarifications pertaining to the guidelines on overseas investment?

Ans. The guidelines have been notified by the Reserve Bank of India *vide* Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time-to-time, which can be accessed at the Reserve Bank's website. A Master Direction titled 'Master Direction on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad' has been issued. The Master Directions consolidate instructions on rules and regulations framed by the Reserve Bank under various Acts including banking issues and foreign exchange transactions and is available at 'Notification' Section on RBI's website https://www.rbi.org.in.

Any further clarifications in respect of cases not specifically or generally covered by the instructions may be obtained from the concerned Authorized Dealer (AD) bank. If, however AD bank fails to provide satisfactory reply, a request may be made, giving full details of the case, to the Central Office of the Reserve Bank by routing it through AD bank at the mentioned address.

Q.5 What is JV and WOS?

Ans. "Joint Venture (JV)"/ "Wholly Owned Subsidiary (WOS)" means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party/Resident Indian makes a direct investment.

A foreign entity is termed as JV of the Indian Party/Resident Indian when there are other foreign promoters holding the stake along with the Indian Party. In case of WOS entire capital is held by the one or more Indian Party/Resident Indian.

D. We have discussed below few recent compounding orders issued by RBI

A. Transfer or Issue of any Foreign Security (FEMA 19/2000-RB)

1. Extending Loan to Second Level SDS without having equity participation in it.

Applicant	Zee Entertainment Enterprises Limited
Compounding Application Number	C.A. NDL 4761/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 44,87,500/-
Date of order	29th January, 2019
Facts of the case	The applicant company provided a foreign currency loan (out of FCCB proceeds lying abroad) to Asia TV Limited (UK), its second level SDS. This loan is provided by the applicant company without having any equity participation in the second level SDS.
Selected Contravention	Extending Loan to Second Level SDS without having equity participation in it: Regulation 6(5) of FEMA Notification No. 19 states that an Indian party may extend a loan or guarantee to or on behalf of the JV/WOS abroad provided that the Indian party has made investment by way of contribution to the equity capital of JV.
Comments	Though Foreign Exchange Management (Transfer or Issue of any Security) Regulations 19/RB-2000 has been replaced by revised regulations; Regulation 6(2) of extant FEMA 120/2004-RB dated 7-7-2004 corresponds to Regulation 6(2) of of erstwhile FEMA 19/2000- RB dated May 3, 2000. Is it to be borne in mind that loan/guarantee to or on behalf of JV/WOS can be extended only if Indian company has equity participation in such JV/WOS.

B. Transfer or Issue of any Foreign Security (FEMA 120/2000-RB)

1. Method of Funding of ODI through the existing Joint Venture (JV) of the applicant.

Applicant	Shapoorji Pallonji Oil and Gas Private Limited
Compounding Application Number	C.A. NDL 4751/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 63,452/-
Date of order	10th January, 2019

Facts of the case	The applicant company had set-up a JV, Karapan Armada Madura Pte Ltd. in Singapore with 51% stake. The overseas JV was incorporated on October 02, 2017. The Pre-incorporation charge for setting up of this JV was paid by the applicant's existing JV in Singapore, S. P. Engineering Pte. Ltd. These pre-incorporation charges were later capitalised and share certificates were issued in the name of applicant company.
Selected Contravention	Method of Funding of ODI through the existing Joint Venture (JV) of the applicant: Regulation 6(3) of FEMA Notification No. 120/2004-RB lays down the permitted mode of funding for ODI. Funding by way of existing JV of the applicant company is not the permitted mode of funding.
Comments	One JV cannot contribute to the capital of another JV wherein the shares are to be issued in the name of the parent company. It is important to note that the shares cannot be issued in someone else's name than the one who is contributing to the capital of a company as per Regulation 6(3) of FEMA Notification No. 120/2004-RB.

2. Disinvestment of stake in WOS without obtaining prior RBI approval

Applicant	Zensar Technologies Limited
Compounding Application Number	C.A. NDL 4764/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 23,70,099/-
Date of order	16th January, 2019
Facts of the case	The applicant company had set up a JV in Japan namely Zensar Advanced Technologies Limited (ZATL) in 2007 which was subsequently converted into WOS. Due to consistent losses and negative net worth, the applicant company decided to liquidate the WOS. The applicant company disinvested the WOS involving write off without obtaining prior approval from RBI when the receivables were due from WOS and also, the applicant was under the DoE investigation.
Selected Contravention	Disinvestment of stake in WOS without prior RBI approval: Regulation 16 of FEMA Notification No. 120 states that "An Indian party may transfer by way of sale shares of a JV/WOS outside India provided (i) The Indian party does not have any outstanding dues from the JV/WOS (ii) The Indian party is not under investigation by CBI/DoE/SEBI/IRDA or any other regulatory authority in India.
Comments	It is imperative to note that if the Indian party has any outstanding dues receivable from the JV/WOS outside India and also if the Indian party is under the investigation by DoE, prior RBI permission for transfer of shares of JV/WOS should be taken.

ML-529

C. Section 42(1) of FEMA, 1999

Applicant	K. Shanmugam
Compounding Application Number	C.A. NDL 4767/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 36,300/-
Date of order	2nd January, 2019
Facts of the case	The applicant is a resident individual who was the Managing Director of SAFL which was incorporated on November 09, 2005, under the Companies Act, 1956. A compounding application was made by SAFL on December 21, 2015 for compounding of the contraventions of Paragraphs 9(1)(A), 9(1)(B) of Schedule I and Regulation 10A(b)(ii) to Notification No. FEMA 20/2000-RB. In the Compounding Order CA No. MCO3870 dated June 07, 2016. It was held that SAFL has contravened the above FEMA provisions. The applicant was under investigation by the Directorate of Enforcement (DoE)
Contravention	The compounding is sought for contravention of Section 42(1) of FEMA, 1999 which states that "Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly". The applicant was the Managing Director of SAFL when the company contravened the provisions of FEMA.
Comments	This is unique case wherein both the company as well as its Managing Director [person in charge of the company in accordance with Section 42(1)] were deemed to be guilty of the contravention. Penalty amount of ₹ 3,63,000/- was levied on the company under Compounding Order CA No. MCO3870 dated June 07, 2016 whereas penalty amount of ₹ 36,300/- has been levied on the applicant under this compounding order.

CA Rashmin Sanghvi

In Focus – Accounting and Auditing

RBI Reserves

Can RBI pay ₹ 3.6 lakh crores to Government?

Newspapers claim that RBI has a reserve of Rupees 9.6 lakh crore. Government wants a portion of this money to be transferred to it for its expenses. Let us examine accounting and economic details and then you take a view whether these reserves are available for spending or not.

1 RBI Reserves

Look at the RBI balance sheet. It is available at RBI website at the following link: ….

https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1239

Anyone who wants to study this subject may visit RBI website and study its accounts in detail. For ready reference, the short balance sheet is given below.

RBI's Summarised Balance Sheet as on 30th June, 2018

	Capital and Liabilities	**₹ Billion**	**₹ Billion**
1.	Capital and Reserves		67.33
2.	Deposits		6,525.97
3.	**Other Liabilities and Provisions** **Contingency Fund**	**2,321.08**	
	Asset Development Fund	228.11	
	Currency and Gold Revaluation Account (CGRA)	6916.41	
	Investment Revaluation A/c Rupee series	132.85	
	FX Forward Contract Revaluation	32.62	
	Total	**9,631.07**	
	Other Liabilities	831.97	
	Total (3)		10,463,04
	Issue Department Liabilities for Rupee Notes issued		19,119.60
	Total Liabilities		**36,175.94**
	Total Assets		**36,175.94**

ML-531

2. Provisions

Please note that as per RBI balance sheet (B/S), total share capital and reserves are ₹ 67.26 bn. There is no other reserve in the balance sheet. All the amounts actually **represent provisions made by RBI.** When someone says that they want to spend RBI reserves, it amounts to saying that "RBI has made certain provisions. Government and media consider the provisions to be excessive. They want the provisions to be written back/transferred to Profit and Loss Account and want RBI to declare dividend out of it."

RBI has appointed Bimal Jalan Committee to examine and suggest what ratio of reserves would be reasonable; when surplus can be transferred by RBI to GOI. While the committee will do its work, let us see some major items on RBI's B/S. Media has been talking of RBI's reserves of ₹ 9,631 bn. We examine the position purely from accounting, economic and prudential view-points.

3. Liabilities of Issue Department – ₹ 19,119.60 bn.

RBI Act requires that for all the notes issued, there should be a 100% reserve available with the RBI. As is known, every currency note issued by Government or by RBI represents a liability of GOI or RBI. This amount represents total notes issued by RBI and it is not money available with RBI. An equivalent amount is invested by RBI and is shown separately on RBI B/S. Government is not talking of spending this reserve/liability. Hence we will not discuss this item.

4. Other liabilities and provisions ₹ 10,463.04 bn.

These are RBI's liabilities and provisions out of which, as per GOI and Media a major part is available to be paid to GOI. Economic Times dated 4th November, 2018 says: "RBI is sitting on ₹ 9.6 lakh crores." (₹ 9,600 billion or ₹ 9.6 trillion.) It includes contingency reserves and revaluation reserve.

5. Contingency Fund

Look at point No. 3. ₹ 2,321.08 bn. is a contingency fund. RBI would have created contingency reserves over its life span to meet with several challenges. GOI and Media think that this is excess provision. I would go by RBI's judgment. Still however, we will have a look at history in the paragraph below. Then you form your opinion – what is adequate/ excess provision.

RBI's Contingency Fund (CF) is a provision. There is money available with RBI. Where has it been invested? Is it in share and securities portfolio – which can be sold when funds are needed? No. RBI funds are invested in Indian Government securities and in Foreign Government bonds. If Government wants RBI to use this fund and declare dividend, either GOI has to repay the loans; or RBI will have to liquidate these securities in open market. Out of loan repayment or sale proceeds, RBI can declare dividend.

Does it make sense?

6. Currency and gold revaluation account ₹ 6,916.41 bn.

This amount represents currency and gold revaluation account. Now look at this figure from different angles. We do not have a break up of Foreign Exchange revaluation reserve and gold revaluation reserve. So **we will assume some figures** and discuss the concept of RBI Reserves.

7. Foreign Exchange Revaluation Reserve

Let us assume that in the year 2000, RBI had total foreign exchange reserve of US $ 40 bn. This amount was acquired by RBI before the year 2000 at varying prices of foreign currency. To simplify the calculations, we ignore other currencies and consider US $. Let us say, US $ price was ₹ 47 per dollar in the year 2000. In Rupee terms, that 'asset' would be valued at ₹ 1,880 bn. Today (30th December, 2018), Rupee has depreciated by 49% and gone down to ₹ 70 per dollar. The **irony of accountancy** is that while India as a whole has suffered massive losses due to significant depreciation of Rupee, RBI balance sheet will show that the $ 40 bn. held by RBI have appreciated to ₹ 2,800 bn. ($40 bn x ₹ 70 per Dollar). There is a profit of ₹ 920 bn. This is the amount that RBI shows as revaluation reserve and Government wants to spend. Do you think, this is an amount which can be spent?

Note: Some people may not agree with my statement that India has suffered massive losses due to Rupee depreciation. But that is another story to be discussed some other time. Today we focus on real meaning of RBI reserves and provisions.

Consider an Illustration

Mr. CA has an office that he purchased in the year 2000 at a cost of ₹ 1 crore. Today, this office is worth ₹ 3 crore. Mr. CA wants to prepare Balance Sheet (B/S) at current market value. So he shows asset at ₹ 3 crore and makes a revaluation reserve of ₹ 2 crore. In books, his capital has gone up by ₹ 2 crore. Can he spend this money (₹ 2 crores)? Where is the money? There is no money. Asset revaluation does not generate any money. He can't use money without selling the office. CA can sell the office, retire and go home.

Similarly, RBI has FX reserves of US $ 400 bn. It cannot generate cash to pay dividend to GOI – unless RBI sells the FX reserves. RBI cannot close business. But, let us say, RBI can sell – say, $ 100 bn. in the market and generate ₹ 7000 bn. to pay to GOI. What will happen in the FX market? Rupee can go up from ₹ 70/$ to ₹ 65/$. Additional money in the monetary system will have its own issues.

8. What is the meaning of foreign exchange reserve?

It is an illusory term. When we say that there is a reserve, people feel that it is generated out of profits made. In case of a company regulated by Indian Companies Act, such assumption would be correct. However, in reality, RBI has not created this reserve out of profits earned.

8.1 When an Indian businessman exports goods or services, he earns foreign exchange. RBI does not earn foreign exchange. It is the Indian businessman, who earns the foreign exchange. Under FEMA, every Indian resident is compelled to sell the foreign exchange earned by him to his authorised dealer (bank). The bank surrenders the foreign exchange to RBI. This is how RBI accumulates the foreign exchange reserve.

For every dollar of foreign exchange surrendered to RBI, equivalent amount of Rupees are paid to the exporter. As any economist understands, every Rupee issued by RBI is a liability. If RBI has $ 400 bn. on the asset side of its balance sheet, an equivalent amount is its liability as Rupee notes issued to exporters.

8.2 The FX reserve can accumulate in several different ways. When a foreigner invests in India (FDI), he remits $ to India. RBI takes away the $ and gives Rupee to his investee company. The FX balance represents India's FX liability towards foreign investors. When an NRI sends remittance and holds NRE or FCNR accounts with banks in India; that FX balance goes to RBI. It is counted as India's FX reserve. But in reality, it is India's liability.

When Government wants to spend this money, one should understand that there is no Rupee balance available to spend. It is foreign exchange which may be spent in terms of exchange fluctuation. An equivalent amount is already pushed into the Indian monetary system. By again spending this amount, Government would spend double the amount. In popular terms, it would amount to **"Printing Notes out of Thin Air".**

Conclusion is that the first serious misunderstanding by media and by Government is that they are calling non-existing funds and liabilities as reserves. And they want to spend the non-existing funds. Strange ways of double entry book keeping are such that "experts" can make any claim and public will believe them.

9. As we know, in the year 1991, India's foreign exchange position – with less than $ 6 bn as reserve - was extremely bad. Dr. Manmohan Singh the then Finance Minister of India, had to physically send 100 tonnes of gold abroad to get credit. Since then a lot of improvement has taken place. So let us take 1st April, 1992 as the base date. Gold price on 1st April, 1992 was ₹ 4,300 per 10 grammes (24 carat). Between the year 1992, and the year 2000, RBI got a total stock of 270 tonnes of gold. We don't know the actual cost. But let us assume that the gold has been purchased at an average price of ₹ 5,000 per 10 grammes. **Hence, total cost of 270 tonnes @ ₹ 5,000 per 10 grammes comes to ₹ 135 bn.**

Today, the price of gold is ₹ 32,000 per 10 grammes. Hence, this same amount of gold will be revalued at ₹ 864 bn. In a balance sheet, this would show as **₹ 729 bn. (864 - 135) being revaluation reserve.**

Is it actually a reserve?

In reality, Indian Rupee has depreciated causing substantial loss to the Indian economy. India has not gained. But because of the peculiar manner of presenting assets at market values, this amount of ₹ 729 bn. is shown as a reserve. (A company can revalue its assets at market price. A prudent investment advisor will advise his clients to sell away shares of such a company).

Again, this is the gold that RBI considers necessary to maintain. This is the gold that will be used in case of a future crisis, if any. We should not forget our crisis in the years 1991-1992. We should also not forget massive **speculative attacks on world currencies – including on Indian Rupee in the years 1992, 1997; and an attack on Indian Rupee in the year 2013. The last attack on Indian Rupee succeeded.** Rupee crashed from ₹ 55 per dollar to ₹ 69 per dollar. GOI and RBI either failed to protect Indian Rupee or chose not to protect Indian Rupee. This may remain a mystery. **But that is another story.** (If you have seen - the 1963 English film 'Irma La Douce'; or the 1974 Hindi film 'Manoranjan' – then you would know the meaning of: "But that is another story". In economics there are so many factors that play simultaneously – that discussing all together is impractical.)

10. Double Entry Book-Keeping

Double Entry book-keeping has its own absurdities and idiosyncrasies. Let me illustrate the absurdity. Assume, a businessman makes losses. His capital is lost. And yet it will be reflected on the asset side of his Balance Sheet as – "Accumulated Loss". There is no asset. It is simply that to balance both sides, the loss is shown on "Assets" side. Similarly, a liability does not become capital and a capital does not become liability just because they are shown on the same side of Balance Sheet.

Conclusion

My submission is that neither the foreign exchange nor the gold and certainly not the revaluation reserve is available for spending by anyone. The revaluation reserve is simply not money. It is simply an accounting entry. Under the Companies Act, a company having revaluation reserve cannot declare dividend out of it. Of course, RBI is not bound by the Companies Act. It is governed by RBI Act. However, **prudential norms require that you cannot spend the money that does not exist.**

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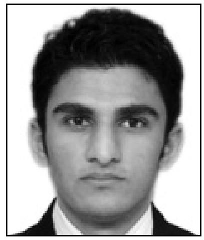

Rahul Sarda, *Advocate*

Best of the Rest

Negotiable Instruments Act, 1881 – Section 138 – Whether an authorised signatory of a company would be liable for prosecution – Necessity of company being arraigned as an accused

According to the complainant-Respondent, the Appellant had borrowed a certain sum from the Respondent. The Appellant issued a cheque in favour of the Respondent for repayment. The cheque when presented for payment was dishonoured with the endorsement of the bank stating 'funds insufficient'.

The Respondent filed a complaint u/s. 138 of Negotiable Instruments Act, 1881 of which cognizance was taken by the Trial Court. The Appellant instituted a petition u/s. 482 of the Code of Criminal Procedure before the High Court for quashing on the ground that the cheque which was dishonoured was issued by the Company and signed by the Appellant as the Director of that Company and not in his individual capacity. It was urged that the complaint ought to have been instituted against the Company and not the Appellant.

The High Court dismissed the Petition.

In appeal against the High Court order, held applying the doctrine of strict construction, commission of offence by the Company is an express condition precedent to attract the vicarious liability of others. Thus, the words "as well as the Company" appearing in the section made it clear that when the Company could be prosecuted, then only the persons mentioned in the other categories could be vicariously liable for the offence subject to the averments in the petition and proof thereof and for maintaining the prosecution as per Section 141 of the Act, arraigning of the company as an accused was imperative.

In the present case, the record before the Court indicated that the cheque was drawn by the Appellant for Company, as its director. Notice of demand was served only on the Appellant. The complaint was lodged only against the Appellant without arraigning the Company as an accused. The provisions of Section 141 postulate that if the person committing an offence u/s. 138 is a Company, every person, who at the time when the offence was committed was in charge of or was responsible to the Company for the conduct of the business of the Company as well as the Company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished. In the absence of the company being arraigned as an accused, a complaint against the Appellant was therefore not maintainable. Hence, the appeal was allowed and the judgment of the High Court was set aside.

Himanshu vs. B. Shivamurthy & Anr., Criminal Appeal No. 1465 of 2009, dated 17th January 2019 - Supreme Court

ML-535

Mutation of a land in the revenue records – whether creates or extinguishes title over land?

The disputes relate to the entries made in the revenue records in relation to the disputed land and the legal value of the entries while deciding the rights of the parties. The present Appeal was filed against the order of the High Court on dispute arising out of the entries made in the revenue records in relation to the disputed lands.

Held, mutation of a land in the revenue records does not create or extinguish the title over such land nor does it have any presumptive value on the title. It only enables the person in whose favour mutation is ordered to pay the land revenue in question.

Smt. Bhimabai Mahadeo Kambekar (D) Th. LR vs. Arthur Import and Export Company & Ors., Civil Appeal No. 1330 of 2019, dated 31st January 2019 - Supreme Court

Whether undivided share in joint family can be disposed by will?

The appellants/plaintiffs filed a suit for 1/10th share in the suit properties described in the plaint. The learned Trial Court decreed the suit declaring that the second plaintiff (since first plaintiff died on 7-7-1978 leaving behind daughter) Smt. Nagamma is entitled for 1/10th share in some of the properties i.e., those properties which were held to be joint family properties. The High Court reversed the decree and the appellants/ plaintiffs claimed before the Supreme Court an independent share as a member of the family in the joint family properties.

The Supreme Court held that prior to coming into force of the Hindu Succession Act, no coparcener could dispose off whole or any portion of his undivided coparcenary interest by Will but by virtue of Section 30 of the Act read with explanation, a coparcener derived his right to dispose of his undivided share in Mitakshara joint family property by Will or any testamentary disposition i.e., by virtue of law. However, since the testator had bequeathed his share/his undivided coparcenary interest by Will dated 16-6-1962, no further independent share could be claimed by the appellants in the ancestral properties as a member of the family.

Radhamma & Ors. vs. H. N. Muddukrishna & Ors., Civil Appeal No. 7090 of 2010, dated 23rd January 2019 – Supreme Court.

❍❑❍

CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th February, 2019 to 7th March, 2019 are being reported as under:

I. Admission of New Members

1) The following new members were admitted in the Managing Council Meeting held on 13th February, 2019.

LIFE MEMBERSHIP			
1	Mr. Mehendale Kaustubh Pramod	CA	Mumbai
2	Mr. Jain Yashpal	CA	Noida
3	Mr. Maloo Sunil Prakashchand	CA	Ahmedabad
ORDINARY MEMBERSHIP			
1	Mr. S. Dhananjayan	CA	Tirupur
STUDENT MEMBERSHIP			
1	Mr. Katira Dilan Rajesh	ICAI	Jamnagar

II. Past Programmes

1. DIRECT TAXES COMMITTEE

A Study Course on Interpretation of Taxing Statues was held on 16th, 22nd and 23rd February, 2019 at Babhubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The course was inaugurated by Mr. Pradeep Parikh, Ex-ITAT Vice-President. Mr. Vikram Nankani, Senior Advocate, Mr. V. Sridharan, Senior Advocate, Mr. Vipul Joshi, Advocate, Mr. Ajay Singh, Advocate, Mr. K. Gopal, Advocate, Mr. Bharat Raichandani, Advocate and Mr. Subhash Shetty, Advocate were the faculty for this course which was very well received by the participants.

2. INDIRECT TAXES COMMITTEE

A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC of ICAI was held on 7th, 14th, 27th February, 2019 and 1st March, 2019 at GSTPAM, Mazgaon Library, 1st Floor, Vikrikar Bhavan, Mazgaon. The workshop was addressed by CA Dharmen Shah, CA Mayur Parekh, CA Ankit Chande, CA Pranav Kapadia, CA Rajiv Luthia, Mr. Dinesh Tambde, Advocate and Mr. Dhaval Talati.

3. IT CONNECT COMMITTEE

A half day Workshop on IT Security in Tax Consultants Office was held on 22nd February, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate. The workshop was addressed by Mr. Sachin Dedhia.

4. MEMBERSHIP & PR COMMITTEE

A Lecture Meeting on "Life is Beautiful" was held on 8th March, 2019 at Babhubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The meeting was addressed by Swami Gyanvatsaldasji.

5. RRC & SD COMMITTEE

The 42nd Residential Refresher Course was held from 28th February, 2019 to 3rd March, 2019 at Hotel Ramada, Hyderabad. The faculty for the course were Mr. Devendra Jain, Advocate, Mr. Nitesh Joshi, Advocate, Mr. Ajay Singh, Advocate and CA Gautam Doshi. The panellists for the Panel Discussion 'Triveni Sangam", covering Income-tax, Accounting and GST implications of important events, CA Jayesh Gandhi for Accounting, CA Yogesh Thar for Income-tax and CA Parind Mehta for GST. The trustees for Brains' Trust session were Mr. Saurabh Soparkar, Senior Advocate and CA Pinakin Desai.

6. STUDENT COMMITTEE

Industrial visits to the plants of Parag Milk Foods Ltd., and Volkswagen India Pvt. Ltd were conducted on 6th & 7th March, 2019 at their Pune Plant. Students and CTC Members participated in this visits with great enthusiasm.

III. Future Programmes

1. CORPORATE CONNCET COMMITTEE

- A Lecture Meeting on "Current Economic Scenario" and "Ease of doing Business in India" Jointly with ECC of Indo-Japanese Association & Indian Merchants' Chamber IMC is scheduled to be held on 12th March, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate.
- A Lecture Meeting on "Banning of Unregulated Deposit Scheme Ordinance" is scheduled to be held on 15th March, 2019 at Jai Hind College, AV Room, 4th Floor, Churchgate.

2. INDIRECT TAXES COMMITTEE

A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC OF ICAI is scheduled to be held on 12th & 14th March, 2019 at GSTPAM, Mazgaon Library, 1st Floor, Vikrikar Bhavan, Mazgaon.

3. INTERNATIONAL TAXATION COMMITTEE

- 13th Residential Refresher Course on International Taxation, 2019 is scheduled to be held from 20th June, 2019 to 23rd June, 2019 at The Grand Bhagwati, Surat.
- The 5th International Study Tour is scheduled to be held from 25th May, 2019 to 5th June, 2019 at Central Europe.

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- A Full Day Seminar on "Contemporary Issues in International Taxation" is scheduled to be held on 16th March, 2019 at ELTIS, Plot No. 419, Pune. (jointly with Pune Study Group).

4. IT CONNECT COMMITTEE

- A Seminar on Business Intelligence (BI) and Microsoft Power is scheduled to be held on 5th April, 2019 at IMC, Churchgate.
- Visit to CTRLs Data Centre is scheduled to be held on 13th April, 2019 at CTRLs Data Centre, TTC Industrial Area, Mahape, Navi Mumbai.

5. MEMBERSHIP & PR COMMITTEE

A Lecture Meeting on "Dynamic Memory" is scheduled to be held on 11th March, 2019 at CTC Conference Room, 3, Rewa Chambers, 31, New Marine Lines, Churchgate.

6. STUDENT COMMITTEE

- Student Orientation Course is scheduled to be held on 13th, 14th & 15th March, 2019 at Maharashtra Seva Sangh Hall, Mulund West.
- 3rd Dr. Y. P. Trivedi National Tax Moot Court Competition in association with the Moot Court Association of Government Law College, Mumbai is scheduled to be held on 29th & 30th March, 2019.

(For details of future programs, kindly visit www.ctconline.org or refer The CTC News of March, 2019)

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STATEMENT AS PER PRESS AND REGISTRATION OF BOOKS ACT
FORM IV *[See Rule 8]*

THE CHAMBER'S JOURNAL

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I, Kishor D. Vanjara hereby, declare that the particulars given above are true to the best of my knowledge and belief.

KISHOR D. VANJARA
Signature of the Publisher

Date : 9-3-2019

ML-539

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.

ML-540

Indirect Taxes Committee

Half Day Workshop on CGST (Amendment) Act, 2018 & IGST (Amendment) Act, 2018 was held on 9th February, 2019 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate

CA Hinesh R. Doshi (President) giving his opening remarks. Seen from L to R: S/Shri CA Naresh Sheth (Chairman), CA A. R. Krishnan (Speaker) and CA Hemang Shah (Convenor)

CA Naresh Sheth (Chairman) welcoming the speaker

CA A. R. Krishnan addressing the delegates

Section of delegates

Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC OF ICAI was held on 7th February, 2019 at GSTPAM Mazgaon Library, Mazgaon, Mumbai

CA Dharmen Shah addressing the delegates

CA Mayur Parekh addressing the delegates

IDT SC on Recent GST Amendments effective from 1st February, 2019 was held on 15th February, 2019 at Jai Hind College, AV Room, 4th Floor, Churchgate

Mr. Archit Agarwal (Group Leader) addressing the delegates

CA Deepak Thakkar (Chairman) addressing the delegates

Pune Study Group

Half Day Workshop on Contentious issues in Transfer Pricing & International Taxation held on 16th February, 2019 at ELTIS, Plot No. 419, Pune

CA Vispi Patel addressing the delegates

International Taxation Committee

FEMA SC on FEMA Regulations for LLPs' (Inbound Investment & Outbound Investment) was held on 21st February, 2019 at CTC Conference Room, Churchgate

CA Siddharth Banwat addressing the delegates

IT Connect Committee

Half Day Workshop on IT Security in Tax Consultants Office was held on 22nd February, 2019 at Kilachand Hall, IMC, Churchgate

CA Hinesh Doshi giving his opening remarks. Seen from L to R: CA Murtuza Ghadiali (Member), Mr. Sachin Dedhia (Speaker) and CA Amit Salla (Convenor)


CA Maitri Savla (Vice-Chairperson) welcoming the speaker


Mr. Sachin Dedhia addressing the delegates

Direct Taxes Committee

ISG on Recent Important Decisions under Direct Taxes was held on 19th February, 2019 at CTC Conference room, Churchgate


Mr. Amar Gahlot, Advocate addressing the delegates

Impact of Union Budget 2019 was held on 2nd February, 2019 at Matunga Gymkhana, Mumbai


CA Hinesh Doshi (President) giving his opening remarks

Faculties


Dr. Kirit Somaiya


CA Kanu Doshi


Mr. Mehraboon Irani


Mr. Gopal Agrawal

Study Circle and Study Group Committee

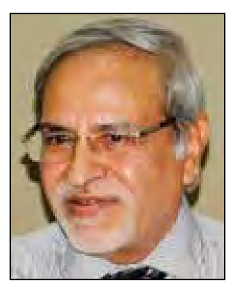
SC on Provisions relating to Deemed Dividend & Issues therein was held on 12th February, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate


CA Ashok Rao (Chairman of the session) addressing the delegates


Mr. Nishit Gandhi, Advocate (Group Leader of the session) addressing the delegates


CA Charmi Shah addressing the delegates

SG on Recent Judgments under Direct Taxes was held on 14th February, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate


CA Kishor Karia addressing the delegates


CA Chirag Wadhwa addressing the delegates

ML-542

Residential Refresher Course & Skill Development Committee

42nd RRC was held from 28th February, 2019 to 3rd March, 2019 at Hotel Ramada, Lucknow

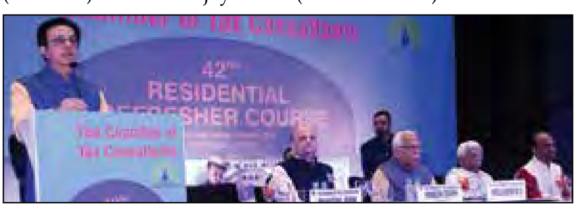
Singing of Saraswati Vandana and National Anthem

Mr. Kishor Vanjara (Advisor) offering shawl to Hon'ble Governor of UP Shri Ram Naikji. Seen in the picture CA Hinesh Doshi (President) and CA Bhavesh Joshi (Chairman)

Hon'ble Governor of UP Shri Ram Naikji inaugurated the RRC by lighting the lamp. Seen from L to R: CA Anish Thacker (Hon. Jt. Secretary), CA Vijay Bhatt (Co-Chairman), CA Bhavesh Joshi (Chairman), CA Hinesh Doshi (President), Mr. Kishor Vanjara (Advisor) and CA Vipul Choksi (Vice-President)

CA Hinesh Doshi (President) presenting memento to Hon'ble Governor of UP Shri Ram Naikji. Seen in the picture CA Bhavesh Joshi (Chairman), Mr. Kishor Vanjara (Advisor) and CA Vijay Bhatt (Co-Chairman)

CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: CA Bhavesh Joshi (Chairman), Hon'ble Governor of UP Shri Ram Naikji, Mr. Kishor Vanjara (Advisor) and CA Vijay Bhatt (Co-Chairman)

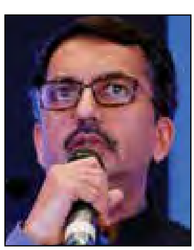


CA Bhavesh Joshi (Chairman) welcoming the Hon'ble Governor and the delegates. Seen from L to R: CA Hinesh Doshi (President), Hon'ble Governor of UP Shri Ram Naikji, Mr. Kishor Vanjara (Advisor) and CA Vijay Bhatt (Co-Chairman)

Hon'ble Shri Ram Naikji delivering his keynote address. Seen from L to R: CA Bhavesh Joshi (Chairman), CA Hinesh Doshi (President), Mr. Kishor Vanjara (Advisor) and CA Vijay Bhatt (Co-Chairman)

Faculties

Mr. Devendra Jain, Advocate



Mr. Vipul Joshi, Advocate

Mr. Nitesh Joshi, Advocate

Mr. Ajay Singh, Advocate

CA Gautam Doshi

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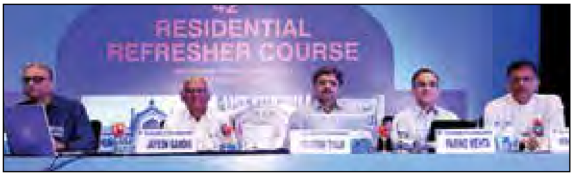

Panel Discussion: On dais from L to R: CA Anish Thacker, Hon. Secretary; CA Jayesh Gandhi, Panellist; CA Yogesh Thar, Panellist; CA Parind Mehta, Panellist and CA Mehul Sheth, Vice Chairman

Brains' Trust Session: On dais from L to R: CA Mahendra Sanghvi, Past President; CA Pinakin Desai, Trustee; Shri Saurabh Soparkar, Sr. Advocate, Trustee and CA Parimal Parikh, Past President

Musical Evening

Musical Evening

City Tour of Lucknow

Group Photo of RRC & SD Committee

Group photo with Hon'ble Governor of UP Shri Ram Naikji

Group Photo of 42nd RRC

Direct Taxes Committee

Study Course on Interpretation of Taxing Statutes was held on 16th, 22nd & 23rd February, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate

Faculties

CA Hinesh Doshi (President) giving his opening remarks.

Mr. Devendra Jain (Chairman) welcoming the speakers

Mr. Pradeep Parikh, Advocate & Ex Vice-President, ITAT delivering his keynote address

Mr. Vikram Nankani, Senior Advocate addressing the delegates

Mr. V. Sridharan, Senior Advocate addressing the delegates

Mr. Vipul Joshi, Advocate addressing the delegates

Mr. Ajay Singh, Advocate addressing the delegates

Mr. K. Gopal, Advocate addressing the delegates

Mr. Bharat Raichandani, Advocate addressing the delegates

Mr. Subhash Shetty, Advocate addressing the delegates


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THE CHAMBER'S JOURNAL

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