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THE CHAMBER'S JOURNAL

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January 2020

Your Monthly Companion on Tax & Allied Subjects

Taxation of Immovable Properties

(From Personal Taxation Point of View)

HEAVEN BE OUR GUIDE
Estd. 1926
ज्ञानं परमं बलम्

A Monthly Journal of
The Chamber of Tax Consultants

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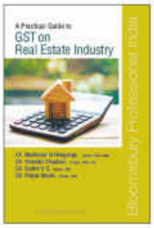

The purpose of this book is to enable the taxable person to understand the applicability and impact of GST provisions with respect to the Real Estate Industry. The comprehensive and in-depth practical knowledge of the four authors would help in implementation of the provisions in an easy manner.

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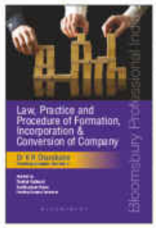

The book presents the law and procedures concerning formation, incorporation and conversion of a company under the Companies Act, 2013, with several specimens and precedents. It would be immensely useful by Company Secretaries, Law professionals, Chartered Accountants and everyone concerned with formation, incorporation and conversion of a company. Each chapter explains the law, with the help of English and Indian case law, and procedures on almost all matters requiring procedural compliances.

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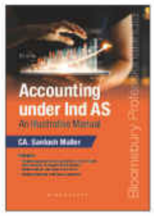

Ind AS transition has resulted in high-quality, principles-based, globally comparable financial reporting of large Indian companies. The transition not only impacted the financial results of companies, but also caused far reaching consequential business impact. Since last two years, there have been several changes in Ind AS for example, amendments in the revenue recognition standard and new leases standard has drastically changed the performance reporting in the balance sheet composition of companies.

CA. Santosh Maller;
INR 2,995/-; 1816 pages

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The Chamber's Journal

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E-Journal Subscription - Single Journal	200	36	236

Editorial

NEW YEAR!.......... HAPPY NEW YEAR!............. (UN)HAPPY NEW YEAR!.......

A new year is always greeted as 'happy new year'! It has been so, so customarily that the word 'happy' has become integral part of the words 'New Year'; rightly so as it signifies hope for the future and burying of the past – the most important life surviving essentials for the human kind!

However, this year, it was not so for many tax practitioners, on account of the 'new year gift' given by the assessing officers in the form of very high-pitched assessment orders preceded by absence of proper opportunity of being heard to the assessees and followed by the ever and omnipresent fear of coercive recovery proceeding that accompanies such orders. Though something was expected on account of 'demonetized period' involved in the assessments this year, what has caught attention is the manner in which such assessments are framed. There has been consistency in the inconsistencies in the approach of the Department. Be that it may, the legal remedies being availed by the assessees will take their own course.

But what has been observed this time is:

(1) Confusion about the new system of electronic service of notices and communications by the Department, sometimes taking undue advantage thereof;

(2) Absence of fair and reasonable opportunity of being heard; and

(3) High pithed assessments made in hurry.

Some of the aspects are worth taking note seriously, taking a macro view, and may warrant not only strong representations but also judicial intervention.

One only hopes that the new initiatives of e-communications and faceless assessments – which are indeed path breaking well come measures to combat corruption, apart from bringing transparency and accountability – achieve the desired objectives and nobody – from either side - is allowed to misuse or circumvent the new system for ulterior purposes.

THE SPECIAL STORY

The Special Story for this issue is "Taxation Issues With Respect To Immovable Properties (From Personal Taxation Point of View)". This topic is, indeed, very complex but at the same time is quite interesting and fascinating. It involves interaction with other laws, rules and regulations, apart from with accountancy concepts and principles. In India, transactions of immovable properties involve the greatest numbers and amounts of unaccounted money/black money. And hence are onslaught of artificial and deeming provisions introduced under the Income-tax Act in the guise of having a check over such transactions; alas, at the cost of diluting some of the finer fundamental concepts of law and income-tax in the process.

I hope the readers would gain some insight into this complex issue through this Special Story.

I wish everybody Happy Budget!

Vipul B. Joshi
Editor

From the President

Dear Members,

Wish you and your family a very happy, healthy and fulfilling New Year 2020 !

The year 2019 proved dynamic for India and was marked by key political decisions, space missions and India winning honours across the world. Some of the events which defined India are: the surgical strike by the Indian Army at Balakot, the NDA Government winning the general election for the second time in succession with an absolute majority, the Supreme Court declaring Instant Triple Talaq unconstitutional, the scrapping of article 370 and Jammu and Kashmir losing special status, the launching of Chandrayaan 2 by ISRO which achieved 95% of its mission, the Ayodhya Verdict by Supreme Court and last but not the least, the passing of Citizens Amendment Bill which has led to wide protests across the country leading to loss of life and property. While the Government continues its efforts in explaining the nuances of the bill to the people at large, the protests continue. Let us hope that wiser sense prevails and protests soon come to an end. On economic front it was a poor year, with an overall slowdown in the economy and one of the worst GDP growth periods in the recent past.

At the dawn of the new year, 2020, let us all wish and pray that there would be much needed positivity all around. The Prime Minister had a series of meetings with the leading business leaders in the recent past seeking their suggestions on policy measures to boost the growth, revive the economy and accelerate the drive towards $ 5 trillion economy. The Finance Minister also has announced a ₹ 102 crore National Infrastructure Pipeline to ensure fast tracking of projects and projects worth ₹ 3 lakh crore would be added soon. The Government is aware of the fact that the economy is not doing too well and is making sincere efforts in right earnest to revive the economy. Let us hope that these efforts would yield the desired results and that the year 2020 will be a much better year for all us Countrymen.

As the new year begins, The Chamber continues to keep the vision of disseminating knowledge alive, in spirit and practice, through regular Seminars, Workshops, Study Circle meetings and webinars, thanks to untiring efforts by all the Chairmen. The past month witnessed as many as seventeen events conducted by various Committees, Study Groups at Hyderabad and Bengaluru and Delhi Chapter. The highlight of the month was the four day Intensive Study Course on FEMA which met with an overwhelming response and *Chai pe Charcha* on *Sabka Vishwas* (Legacy Dispute Resolution) Scheme, 2019 jointly with the Central Board of Indirect Taxes and Customs, Mumbai East Division for which we were invited by the local office of CBIC. Students Committee organized Interactive Workshop for Students on GST Annual Return and GST Audit jointly with WIRC which as usual received very good response from the students.

All the committees have organized various Seminars, Study Circle meetings, webinars of professional importance for its members details of which are given in the Newsletter. The Commerce and Allied Laws Committee has organized a three days conclave from 13th to 15th March, 2020 on Securities Law jointly with National Institute of Securities Market at NISM Campus, Patalganga. Such a conclave on this subject is being organized for the first time by the Chamber with an Educational Institute promoted by SEBI and eminent professionals will be the faculty. I am sure professionals practising in this area and also those wanting to develop practice in this area, will take advantage of this conclave and enroll for the same. With ever increasing responsibilities of auditors, the Accounting and Auditing Committee has organized webinar series on auditing standards in February and March 2020.

Students committee has organised quite a few events for its student members including industrial visit to Sahyadri Farms on 6th March 2020. Do encourage your students to participate in these events which would definitely be beneficial to them.

Life of a professional is quite stressful with pressure of compliance, deadlines and ever changing laws. It is therefore quite imperative that one unwinds onself by participating in non technical events of the Chamber. Like last year, this year too, the Membership and PR and Students Committee have organized a Musical programme by the Chamber's own members and their immediate family members, *"Meri awaz he pahechan hai….."* along with dinner on 8th February, 2020 and an Inter Firm Indoor Box Cricket Tournament on 15th February, 2020. Do participate in both the events to unwind yourself.

This issue of the Journal is on a very important subject of Taxation of Income from Immovable Properties for Individuals. The efforts of the Chairman and the members of the Journal Committee are laudable in bringing out the issues on topics which are most relevant for the members and in a timely manner. I also thank all the authors for sharing their expert knowledge and sparing their valuable time for such a noble cause.

I would like to sign off with a very beautiful quote by *Confucius*

"Life is really simple, but we insist on making it complicated"

VIPUL K. CHOKSI
President

Taxation Issues of Redevelopment of Residential and Commercial Property (in a society)

CA Jagdish T. Punjabi

1 Introduction

1.1 This article discusses income-tax issues in redevelopment of residential and commercial property in a society. It does not cover the provisions of Section 45(5A) of the Income-tax Act, 1961 ("the Act") which are applicable only to an individual or a Hindu Undivided Family entering into a `specified agreement' as defined in *Explanation (b)* to Section 45(5A). The income-tax issues in respect of redevelopment of a property in a society will be different if the society is undertaking redevelopment itself by appointing contractors, etc. or whether the society is giving development rights to a developer.

1.2 This article deals with income-tax issues arising upon a society entrusting redevelopment to a developer. The income-tax issues, in such a scenario, will be those which affect the society, its members and the developer. Issues affecting taxation of the developer are not covered in this article. The property being redeveloped/ the units in the property of the society could be residential and/or commercial. Different issues will arise depending upon whether the property is residential and/or commercial. This article deals with both types of properties.

1.3 Since the subject matter of discussion wherefrom the issues emanate is the Development Agreement, it would be useful to first understand what are development agreements. The Mumbai Bench of the Tribunal, in the case of ***ITO vs. Ronak Marble Industries [ITA No. 3318/ Mum./2015; A.Y. 2009-10; Date of Order: 14-3-2017],*** has held that–

"Development Agreements are agreements where the developer agrees to put up construction on owner's plots in consideration of his parting with a part of the plot.

The development agreement is some sort of business agreement and it basically postulates coming together of two parties only i.e., the developer and the owner of the land. The developer does not have land to develop and the assessee (land owner) does not have sufficient finance to develop the land and therefore they come together i.e., land and finance for the development of project is necessarily a business agreement whereby the owner of land allows the developer to enter and exploit the land for the limited purposes of developing the said land."

1.4 Typically, a society owns land and the building thereon. The flats/units in the building of the society are occupied by members of the society who hold shares in the share capital of the society. With passage of time, building of the society becomes dilapidated and the society does not have requisite funds and/or the expertise to reconstruct the building belonging to the society. Also, with amendments in the Development Control Regulations, the construction permissible on plot of the society undergoes a change in an upward direction. The increase in permissible construction [FSI (Floor Space Index)] is on account of Base FSI increasing and/or the entitlement of the society to utilise TDR FSI on its plot. Possibly, some societies also have balance of unutilised Plot FSI/Base FSI. The developer is interested in the development potential which can be exploited by him. It is this development potential which attracts him to enter into a development agreement with the society.

1.5 A society which desires to get its building redeveloped appoints a developer. The developer, so appointed, to undertake redevelopment enters into a development agreement with the society and its members. The parties to the development agreement are the society (as the owner of the land) and the developer (as the party undertaking redevelopment) and the members of the society (as confirming parties). apart from the development agreement the Builder enters into a permanent alternate accommodation agreement with each of the members of the society who are occupying the flats in the building of the society. Under the terms of the development agreement, the developer undertakes to –

(i) demolish the existing building and in its place construct a new building (which has several modern amenities and facilities) and provide flats/units in the new building to the members of the society in lieu of their existing flats. Generally, the flats/units to be allotted are bigger than the flats/units which are occupied by the members of the society;

(ii) a lump sum consideration is paid to the society towards the corpus fund. This amount is then invested by the society and the income earned thereon is utilised by the Society to meet the increased cost of maintenance of the new building. In some cases the consideration, at the instance of the society, is paid to the members of the society. In such cases, the amount of monetary consideration is paid to the members in proportion of the areas of their existing flats/ units. This alternative presumes that the TDR entitlement belongs to the members through the society. However, the society continues to be a party to the redevelopment agreement;

(iii) while the construction is in progress, the developer agrees to pay to the members of the society a monthly compensation in order to meet the expenses on renting an alternate accommodation and at times, a lump sum amount is paid to the members to incur expenses towards shifting from the present premises to rented premises and then shifting back, upon the construction of the building being completed, to the flat in the newly constructed building. This amount is called by different names such as hardship allowance; transit accommodation charges; inconvenience allowance, etc.

(iv) the members are entitled to purchase additional areas (i.e., area over and above their entitlement) for an agreed consideration which is lower than the rate at which the developer sells its entitlement to outsiders;

(v) the development agreement provides that in case there is a delay in construction of the building by the developer, the developer undertakes to pay damages/penalty.

1.6 In consideration of having undertaken the above, the developer becomes entitled to sell the flats/units constructed by him by utilising the entire development potential after having provided areas agreed to be provided to the members of the society. The developer is entitled to deal with the consideration received on sale of such flats/units. The persons to whom the flats/units are sold by the developer become members of the society.

1.7 Keeping the above terms in mind, the tax consequences of a society entering into a development agreement are discussed hereinafter. Broadly, the following issues arise –

(i) is the amount of consideration received by the society a revenue receipt chargeable to tax or is it a capital receipt?

(ii) is there a gain chargeable to tax in the hands of the society?

(iii) if the answer to the above is in the affirmative, what is the full value of consideration? Does it also include the value of the flats allotted to the members of the society? Is monetary consideration due to/received by the members also part of full value of consideration for computing capital gains, if any, in the hands of the society?

(iv) are provisions of section 50C applicable to transfer of development rights?;

(v) are the amounts received by members towards rent for alternate accommodation, brokerage, shifting expenses, inconvenience allowance taxable in their hands? If yes, is taxability the same irrespective of whether the property is a residential property or a commercial property?

(vi) is the value of additional area received by the member, free of cost, from the developer taxable in his hands? If yes, under which head of income and how does one compute the value? Can a member who is an individual/HUF claim exemption under section 54?

(vii) In case it has been agreed under the terms of redevelopment that the developer will provide to the members of the society, additional areas over and above their entitlement under the development agreement for a consideration which is lower than the price at which the Developer is selling to outsiders then are the provisions of section 56(2)(x) attracted?

(viii) what will be the income-tax consequence to the Member of the Society in the event that the property is a commercial property?

Each of the above mentioned issue is dealt with hereinafter.

2 Is it a transaction in the course of business?

2.1 The transaction of a society entering into a development agreement to exploit the development potential of the plot of land belonging to the society is not a transaction entered into by the society in the normal course of its business. The amount which accrues to and/or is received by the society from the developer under the development agreement is not a revenue receipt. It is not `income' as is commonly understood. It is not `income' under any of the sub-clauses of section 2(24) of the Income-tax Act, 1961 ("the Act"). Therefore, the amount of consideration is not chargeable to tax under the head `Profits & Gains of Business or Profession'. It cannot even be brought to tax under the head `Income from Other Sources'.

2.2 Since the consideration received on entering into a development agreement is not a revenue receipt for the society, the receipt will be chargeable to tax only if it is taxable under the head `Capital Gains' viz. if there is a capital asset, there is a transfer of such capital asset, profits or gains arise as a result of transfer and the computation mechanism provided in the Act for computing capital gains does not fail.

3 Are development rights a capital asset?

3.1 The society by entering into a development agreement transfers the development potential of its plot of land to the developer. What is transferred by the society to the developer is the right to construct areas by utilising the plot FSI as also the TDR FSI and/or Fungible Compensatory FSI ("Fungible FSI"). The plot of land belonging to the society continues to belong to the society even after redevelopment and even after the developer has sold all the flats/units which he is entitled to sell in the new building constructed by him. Therefore, the land belonging to the society is not transferred but it is only the development rights which are transferred.

3.2 The Mumbai Bench of the Tribunal, in the case of ***ITO vs. Bharat Raojibhai Patel [(2016) 70 taxmann.com 401 (Mum.– Trib.)],*** has held that development rights are a capital asset. The Tribunal, in this case, held that gains on sale of development rights over property are capital in nature and come within the definition of capital asset under section 2(14) and therefore, the gains arising on transfer thereof are taxable as capital gains. Since gains are capital gains, consequential deductions/exemptions would be allowable subject to satisfaction of conditions mentioned in the respective sections under which exemption is claimed.

4 What are the components of the development rights transferred by a society?

4.1 The development rights transferred by the society may comprise of the balance development potential of the plot of land (i.e. base FSI) owned by the society i.e. the base FSI and/or the right to load TDR FSI and/or right to construct additional areas by utilising Fungible FSI. From a tax perspective, it is desirable that the consideration be separately stated for each of the development potentials viz. the consideration for transfer of base FSI, the consideration for transfer of right to load TDR FSI and consideration for permitting the developer to construct areas on its plot of land by utilizing the Fungible FSI.

5 Is the right to load TDR FSI a capital asset?

5.1 The Mumbai Bench of the Tribunal, in the case of ***ITO vs. Mrs. Chetana H. Trivedi [(2012) 24 taxmann.com 175 (Mum. – Trib.)],*** has held that the right to load TDR FSI is a capital asset and consequently consideration received by an assessee for transfer of rights over such capital asset would clearly fall within the provisions of Section 45 of the Act. It is submitted that the ratio of this decision will apply with equal force to right to construct additional areas by utilizing Fungible FSI since the nature of right to load TDR FSI is similar to the nature of right to construct additional areas by utilising Fungible FSI.

6 Year of taxability

6.1 Since the amount of consideration accruing or arising as a result of grant of development rights is to be considered for taxation under the head 'Capital Gains', the charge, as per provisions of Section 45 of the Act, will arise in the year in which the transfer takes place.

6.2 Section 2(47) of the Income-tax Act, 1961 ("the Act") defines the term 'transfer'. The following clauses of the definition of `transfer' are relevant for this purpose –

"2(47) "transfer" in relation to a capital asset, includes –

(i) the sale, exchange or relinquishment of the asset; or

(ii) ….

(iii) ….

(iv)

(iva) …..

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or any association of persons or by way of any agreement or arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property."

6.3 A question which arises for consideration is whether the case of a society entering into a development agreement will fall under which of the above stated sub-clauses of Section 2(47). The case of entering into a development agreement of the nature described above is not a case of an 'exchange' because **exchange presupposes existence of both the properties at the time of entering into a transaction.**

6.4 The Hyderabad Bench of the Tribunal has, in the case of ***Fibars Infratech P. Ltd. vs. ITO [(2014) 46 taxmann.com 313 (Hyd.-Trib.)],*** held *"To say that there is an exchange under Section 2(47)(i), both the properties which are subject matter of the exchange in the transaction are to be in existence at the time of entering into the transaction. It is to be noted that at the time of entering into development agreement on 15-12-2006, only the property i.e., land pertaining to the assessee is in existence. There is no quantification of consideration or other property in exchange of which the assessee has to get for handing over the assessee's property for development. The contention of the department is that the consideration accrued to the assessee in the form of 16 villas comprising of developed land of 9,602 sq. yards and built-up area of 58,606 sq. feet which the assessee has to get on completion of the project. There was no progress in the development work in the assessment year under consideration as the project is only in conception stage and it is not appropriate to tax the assessee on imaginary reasons. [Para 57]"*

6.5 Generally, entering into a development agreement would constitute 'transfer' only by virtue of sub-clauses (v) and/or (vi) of Section 2(47) of the Act. For a transaction to be covered by sub-clause (v) it has to be 'of the nature referred to in Section 53A of the Transfer of Property Act'. Supreme Court has in the case of ***CIT vs. Balbir Singh Maini [(2017) 86 taxmann.com 94 (SC)]*** held that *"All that is meant by this expression is to refer to the ingredients of applicability of section 53A to the contracts mentioned therein. It is only where the contract contains all the six features mentioned in* ***Shrimant Shamrao Suryavanshi vs. Pralhad Bhairoba Suryavanshi [2002] 3 SCC 676,*** *that the section applies, and this is what is meant by the expression 'of the nature referred to in section 53A'."*

6.6 Supreme Court, in the case of ***Shrimant Shamrao Suryavanshi vs. Pralhad Bhairoba Suryavanshi [2002] 3 SCC 676,*** has held that –

"there are certain conditions which are required to be fulfilled if a transferee wants to defend or protect his possession under Section 53-A of the Act. The necessary conditions are –

i) there must be a contract to transfer for consideration any immovable property;

ii) the contract must be in writing, signed by the transferor, or by someone on his behalf;

iii) the writing must be in such words from which the terms necessary to construe the transfer can be ascertained;

iv) the transferee must in part performance of the contract take possession of the property, or of any part thereof;

v) the transferee must have done some act in furtherance of the contract; and

vi) the transferee must have performed or be willing to perform his part of the contract.

6.7 Therefore, it is only on satisfaction of all the six conditions mentioned hereinabove that there will be a 'transfer' contemplated by clause (v). Possession has to be absolute possession and not merely a licence to enter upon the property for the purposes of complying with the obligations under the development agreement.

6.8 The 'willingness' has to be absolute and unconditional. If willingness is studded with a condition, it is no more than an offer and cannot be termed as willingness – ***Fibars Infratech Pvt. Ltd. vs. ITO [2014] 162 TTJ 228 (Hyderabad - Trib.)].*** In this case, on facts, the Tribunal held that willingness of the developer to perform his part of the obligation is not ascertainable in AY 2007-08 because (a) the consideration was not paid to the assessee; (b) the building plans had not been approved; (c) there was no progress with regard to development in AY; (d) there was no investment by the developer in the construction activity in the AY. In this factual position, the Tribunal held that *"it is not possible to say whether the developer is prepared to carry out those parts of the agreement to their logical end. The fact that the assessee has given possession is not relevant. Consequently, S. 2(47)(v) does not apply and the capital gains is not assessable to tax."*

6.9 The Hon'ble Bombay High Court has in the case of ***CIT vs. Sadia Shaikh (Bom. HC)(www.itatonline.org)[Tax Appeal Nos. 11 & 12 of 2013; Order dated 2-12-2013]*** has held that mere execution of a development agreement is not 'transfer' if possession as per Section 53A of the Transfer of Property Act is not given.

6.10 The Mumbai Bench of the Tribunal has in the case of ***Dilip Anand Vazirani vs. ITO [(2015) 69 SOT 1 (Mumbai-Trib.)]*** held that *'mere execution of a development agreement does not result in a 'transfer' if the approval of the municipality is delayed and the developer has not started work.'*

6.11 Therefore, transfer will happen in a year when there is a 'contract' which can be enforced in law under Section 53A of the Transfer of Property Act.

6.12 Applicability of clause (vi) is not examined in many cases. However, it needs to be noted that a case which is not covered by clause (v) could possibly be covered by clause (vi). Supreme Court in the case of ***CIT vs. Balbir Singh Maini [(2017) 86 taxmann.com 94 (SC)].*** The Apex Court has emphasised that *the expression "enabling the enjoyment of" takes colour from the earlier expression "transferring", so that it is clear that any transaction which enables the enjoyment of immovable property must be enjoyment as a purported owner thereof. The idea to bring within the tax net, transactions, where, though title may not be transferred in law, there is, in substance, a transfer of title in fact.* The Supreme Court, on a reading of the Joint Development Agreement, in the case before it, observed that it shows that the owner continues to be the owner throughout the agreement, and has at no stage purported to transfer rights akin to ownership to the developer. At the highest, possession alone is given under the agreement, and that too for a specific purpose – the purpose being to develop the property, as envisaged by all the parties. In the circumstances, the Supreme Court held that clause (vi) will not rope in the present transaction.

6.13 To conclude, some of the factors necessary to constitute a 'transfer' are presence of an agreement; possession having been given; plans having been approved; developer having commenced work/be willing to perform his obligations under the agreement; right been given to the developer to sell the flats/units coming to his share; developer enjoying the rights akin to those of an owner. It is not any one factor which will affect the decision but several facts taken together which will enable one to come to a conclusion that whether there is a 'transfer' within the meaning of clauses (v) and/or (vi).

7 Is there a gain chargeable to tax in the hands of the society?

7.1 The amount accruing as a result of transfer of development rights being a capital receipt the same will have to be considered for taxation in the hands of the society under the head 'Capital Gains'.

7.2 For an amount to be chargeable to tax under the head 'capital gains' following conditions need to be satisfied cumulatively viz.–

(i) there has to be a capital asset;

(ii) such capital asset has to be transferred;

(iii) the transfer is for a consideration; and

(iv) computation mechanism provided in the Act does not fail.

7.3 We have seen in earlier paragraphs that it has been held by the Tribunal that the 'development rights' as also `right to load TDR FSI' are capital asset in the hands of the society. Applying the same analogy, right to construct additional areas by utilizing Fungible FSI can also be said to be a capital asset. Undoubtedly, there is a transfer of development rights from the society to the developer. The transfer is for a consideration. Therefore, the only condition that remains to be examined is whether the computation mechanism fails. One of the situations where the computation mechanism fails is a case where the asset is such that in its acquisition no cost can be conceived.

7.4 As far as the transfer of Base FSI/ Unconsumed FSI/Balance Plot FSI is concerned undoubtedly it is capable for being acquired for a cost. When a person acquires a plot of land he pays for the development potential of the said plot of land. Therefore, the proportionate cost of the plot can be regarded as the cost of the Base FSI/Unconsumed FSI/Balance Plot FSI which is the subject matter of transfer. This would be so even if there has been an increase in Base FSI since the date of acquisition of the plot of land e.g., if the plot of land was acquired in 1970 for a consideration of ₹ 1 crore and the Base FSI then permissible was 1 lakh sq. feet which was then fully utilized. However, subsequently because of the change in Development Control Regulations certain portions of the areas constructed which were then considered as part of FSI are now permissible to be constructed free of FSI and consequently there is a balance of 10,000 sq. feet of Base FSI then one can consider the FMV of this 10,000 sq. feet of FSI as on 1-4-2001 to be its cost of acquisition (assuming of course that the FMV on 1-4-2001 is greater than the cost of acquisition and the assessee chooses to substitute the fair market value in place of the cost of acquisition).

7.5 As far as the right to load TDR FSI is concerned, it is a right which has arisen as a result of an amendment in the Development Control Regulations. This right is not something which was capable of being acquired for a cost. Therefore, applying the ratio of the decision of the Apex Court in the case of ***CIT vs. B.C. Srinivasa Shetty [(1981) 128 ITR 294 (SC)]*** it is argued that the computation mechanism fails when the right to load TDR FSI is transferred. Therefore, consideration received for transfer of right to load TDR FSI is contended to be a capital receipt not chargeable to tax. This proposition is also supported by the following decisions of the Mumbai Bench of the Tribunal –

i) ***Jethalal D. Mehta vs. DCIT [2005] 2 SOT 422 (Mum.)***

ii) ***Maheshwar Prakash-2 Co-op. Hsg. Society Ltd vs. ITO [2009] 118 ITD 223 (Mumbai)***

iii) ***New Shailaja Co-operative Housing Society Ltd. vs. ITO [2009] 121 TTJ 62 (Mumbai)***

iv) ***Land Breez Co. Operative Housing Society Ltd. vs. ITO [2013] 21 ITR(T) 467 (Mumbai)***

7.6 The Mumbai Bench of the Tribunal, in the case of Land Breez Co-operative Housing Society Ltd. (supra) having explained the concept of TDR FSI has laid down the following propositions –

(i) TDR entitlement is capital asset and transfer thereof is 'transfer';

(ii) TDR entitlement is separate and distinct from original right in land and, therefore, an independent capital asset;

(iii) there is no cost of acquisition in acquiring TDR entitlements and therefore, there cannot be any capital gain tax liability.

7.7 The proposition laid down in the above stated decisions of the Mumbai Bench of the Tribunal viz., that there is no cost of acquisition in acquiring TDR entitlements has been approved by the Hon'ble Bombay High Court in the case of ***CIT vs. Sambhaji Nagar Co-op. Hsg. Society Ltd [2015] 54 taxmann.com 77 (Bombay).*** In this case the Court was dealing with the case of a Co-operative Housing Society which acquired right of putting up additional construction through Transferable

Development Right (TDR). This right was acquired consequent to the promulgation of the Development Control Rules, 1991 (DCR). The assessee society, instead of utilising this right itself, decided to transfer the same to a developer for construction of new building which was in execution and the society was eligible for a Floor Space Index (FSI) for a consideration. The Assessing Officer was of the view that the right created by the DCR attached to the land owned by the society which was acquired for a value. Its title on ownership of the plot enabled the society to consume this FSI/TDR. In such circumstances, the AO held it to be a transfer of capital asset held by the society which was chargeable to tax. The CIT (A) confirmed the action of the AO. The Tribunal, while deciding the appeal filed by the assessee, held that the transfer of TDR (sic right to load TDR FSI) did not give rise to any capital gains chargeable to tax. Aggrieved by the decision of the Tribunal, the revenue preferred an appeal to the High Court. The Hon'ble Bombay High Court held as follows -

"In the instant case, additional FSI/TDR is generated by change in the DC. A specific insertion would therefore be necessary so as to ascertain its cost for computing the capital gains. Therefore, the Tribunal was in no error in concluding that the TDR which was generated by the plot/property/land and came to be transferred under a document in favour of the purchaser would not result in the gains being assessed to capital gains. The factual backdrop is noted by the Tribunal and thereafter the rival contentions. The Tribunal concluded and relying upon its order passed in two other cases that what the assessee sold was TDR received as additional FSI as per the DC. It was not a case of sale of development rights already embedded in the land acquired and owned by the assessee. The Tribunal concluded that the assessee had not incurred any cost of acquisition in respect of the right which emanated from 1991 Rules, making the assessee eligible to additional FSI. The land and building earlier in the possession of the assessee continued to remain with it. Even after the transfer of the right or the additional FSI, the position did not undergo any change. The revenue could not point out any particular asset as specified in sub-section (2) of Section 55. The conclusion of the Tribunal is imminently possible and in the given facts. That is also possible in the light of the legal position as noted by language of Section 55(2) and the judgment of the Supreme Court in ***CIT vs. B. C. Srinivasa Shetty [1981] 128 ITR 294/5 Taxman 1,*** *which is in the field [Para 11]"*

7.8 Till such time as the ratio of the above stated decision of the Bombay High Court continues to hold the field it would be safe for an assessee to proceed on the footing that the consideration received for transfer of right to loading TDR FSI is not chargeable to tax under the head 'Capital Gains'. Of course, this proposition will apply only to those assessees who have acquired the plot of land before 1991 and therefore the increase was a result of the amendment in the regulations. The above proposition may not be applicable to those cases where the plot of land has been acquired post 1991 as in those cases it would be arguable to contend that the cost of acquisition paid by the assessee includes the right to load TDR FSI as at that point of time the same was permissible.

7.9 An interesting question arises as to whether the analogy/argument made for right to load TDR FSI would apply with equal force to right to load Fungible FSI. The answer appears to be in the affirmative. Conceptually there is no difference between a right to load TDR FSI and a right to load Fungible FSI. Both are creatures of Development Control

Regulations. In case of TDR FSI, the person desirous of loading TDR FSI has to have a receiving plot and also TDR in the form of DRC (Development Rights Certificates). It is trite to say that the DRC's are available in the market for a consideration. In the case of right to load Fungible FSI there has to be a plot on which Fungible FSI is loadable and also the person desirous of constructing the areas by utilising Fungible FSI has to pay a premium to the BMC. In case of both *viz.* TDR FSI as well as Fungible FSI there is an upper limit beyond which loading is not permissible. Therefore, it is humbly submitted that the ratio of the decisions rendered in the context of right to load TDR FSI would apply equally to right to load Fungible FSI. The fact that Fungible FSI is acquired for a cost would not make the case any distinguishable because in case of TDR FSI also cost has to be incurred for acquiring TDR. Of course, this argument will be available only in those cases where the plot of land was acquired before the concept of Fungible FSI came into operation. The concept of Fungible Compensatory FSI was introduced by an amendment to Development Control Regulations *vide* Notification dated 6-1-2012. In respect of plots acquired after the introduction of concept of Fungible FSI this proposition would not be available as in those cases it is possible to contend that the cost of acquisition of the plot included the cost paid for loading Fungible FSI as the concept of Fungible FSI was in vogue when such an assessee acquired the plot of land.

7.10 In a case where a society for a composite consideration transfers the development potential of the plot of land belonging to it, a question would arise as to whether such a society can also contend that the capital gains arising on transfer of right to load TDR FSI is not chargeable to tax by following the ratio of the decisions mentioned hereinabove or because the consideration is a composite amount it would not be able to avail the benefit of the decisions mentioned in paragraphs 7.5 and 7.7 hereinabove. In this connection, a useful reference can be made to the ratio of the decision of the Mumbai Bench of the Tribunal in the case of ***Ishverlal Manmohandas Kanakia vs. ACIT [ITA No. 3053/Mum./2010; A.Y. 2006-07; Date of Order 30-1-2012; Mum - 'I' Bench].***

7.11 In the case of ***Ishverlal Manmohandas Kanakia (supra),*** the assessee before the Tribunal was owner of land acquired in 1963. Pursuant to the Development Control Regulations, 1991, the assessee was entitled to construct up to 1 : 1 FSI on the property. The assessee was also entitled to load Transferable Development Rights ("TDR") on the property. The assessee entered into a development agreement with a developer pursuant to which the developer agreed to develop on the said land by utilizing the FSI & TDR and paid compensation to the assessee. The assessee claimed that the TDR was an "improvement" of the land and as a "cost of improvement" of the land could not be determined, no capital gains was chargeable. In appeal, the CIT(A) held that the FSI and TDR were separate and distinct assets and that while the TDR did not have a cost, the FSI did and if both were transferred together, there was a "cost" for the "asset" and capital gains was chargeable. On appeal by the assessee, allowing the appeal, the Tribunal held as follows –

"The assessee transferred "Development Rights" being the FSI and the "right to load TDR" on the land. While the right to construct on the land by consuming FSI was a capital asset

which was acquired at a cost, the right to load TDR arose pursuant to the DC Regulations, 1991 without payment of any cost. The said right to "load TDR" was an improvement to the capital asset held by the assessee. If the "cost of improvement" of an asset is not determinable, capital gains are not chargeable."

The result of the decision of the Tribunal was that even the consideration attributable to the FSI (which had a cost) was not assessable to tax (Principle laid down in ***Jethalal D. Mehta 2 SOT 422 (Mum.)*** & ***Maheshwar Prakash CHS 24 SOT 366 (Mum.)*** in the context of only TDR was followed by the Tribunal).

8 If the answer to the above is in the affirmative, what is the full value of consideration? Does it also include the value of the flats allotted to the members of the society? Is monetary consideration due to/received by the members also part of full value of consideration for computing capital gains, if any, in the hands of the society?

8.1 Having seen that transfer of development rights results into a transfer of capital asset and unless it is a case of transfer of right to load TDR FSI/Fungible FSI, the transfer of development rights will attract capital gains. The monetary consideration accruing to/received by the society is the full value of consideration for the purposes of computing capital gains.

8.2 An interesting question arose before the Tribunal in the case of ***Raj Ratan Palace Co-operative Housing Society Ltd. vs. DCIT [2011] 46 SOT 217 (Mumbai)(URO)*** where the Society granted consent to the developer to utilize TDR FSI and construct a building on the plot of land belonging to the society. The society charged the developer a consideration of ₹ 2.51 lakh for granting consent and the developer, in addition, paid to the members of the society amounts aggregating to ₹ 302 lakh. The AO taxed the amounts received by the members also in the hands of the society on the ground that it was the society which was the owner of the land and by virtue of certain clauses in the agreement, according to the AO, the society was entitled to the entire consideration. The AO taxed the society, under section 2(24), even on amount received by the members. The Tribunal observed that *"the society continued to be the owner of the land and no change in ownership of land had taken place."* The Tribunal held that *"mere grant of consent would not amount to transfer of land/or any rights therein."* The Tribunal also noted that some of the individual members had offered the receipts from the developer to tax and the same had also been brought to tax in the hands of the individual members. In these facts, the Tribunal held the addition made in the hands of the assessee society to be without any basis.

8.3 However, it is important to bear in mind that much would depend upon the terms of the agreement. It is advisable that while drafting the documents adequate care is taken to see that the consideration under the agreement accrues to the members and that there is no room to interpret the clauses in the manner that the consideration though received by the members has accrued to the society.

8.4 The value of the additional area allotted to members, free of cost, under Permanent Alternate Accommodation Agreement entered into by each of them with the developer is not charged to tax in the hands of the society but is taxed in the hands of the individual member concerned.

8.5 As far as taxing the amounts which accrue to/are received by the members of the society towards shifting expenses, rent for alternative accommodation, inconvenience allowance, etc. are concerned they accrue to the individual members and are to be considered for taxation in the hands of the members.

8.6 As far as the society is concerned, the tax consequence is the same irrespective of the fact whether the property of the society is a residential property or a commercial property. The nature of property could affect the tax consequence as far as the members of the society are concerned.

9 Are provisions of Section 50C applicable to transfer of development rights

9.1 Section 50C of the Act provides that where capital asset transferred by an assessee is land or buildings or both and full value of consideration of the asset so transferred is less than its stamp duty value then capital gains in respect of the asset transferred (viz., land or building or both) shall be computed by considering stamp duty value of the asset transferred to be full value of consideration.

9.2 The provisions of Section 50C apply to transfer of land or building or both. A question which has arisen before the judicial forums is whether the provisions of Section 50C apply even to transfer of rights in land or building or both. Development rights are rights in land and not land. In fact, in case of a society land is never transferred by the society.

9.3 In the following cases it has been held by the Tribunal that the provisions of section 50C do not apply to transfer of rights in land or building or both.

i) ***Shakti Insulated Wires Pvt. Ltd. vs. ITO (Mum)(URO) [(ITA No. 3710/ Mum/07. Assessment Year 2003-04; Mumbai E-1 Bench, Order dated 27-4-2009)]***

ii) ***Voltas Ltd. vs. ITO [(2016) 74 taxmann.com 99 (Mum.-Trib.)]***

iii) ***ITO vs. Ronak Marble Industries [ITA No. 3318/Mum./2015***; **AY: 2009-10**; Date of Order : 14-3-2017] – application of provisions of section 50C is also bad in the present scenario as no transfer of land or building has taken place.

9.4 The Mumbai Bench of the Tribunal in the case of ***Voltas Ltd. (supra)*** was dealing with applicability of the provisions of section 50C to transfer of development rights by an assessee. The Tribunal held that the provisions of section 50C do not apply to transfer of development rights.

9.5 The Bombay High Court has in the following cases held that the provisions of section 50C do not apply to transfer of rights in land or building.

i) ***CIT vs. Greenfield Hotels & Estates (P.) Ltd. [(2016) 389 ITR 68 (Bombay)];***

ii) ***Heatex Products Pvt. Ltd. [2016 (7) TMI 1393 - Bombay High Court]***

9.6 However, it is relevant to note that the Bombay High Court has, in the case of Pr. ***CIT vs. Kancast Pvt. Ltd. [2018 (5) TMI 713,*** admitted the following substantial question of law *"whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the provisions of Section 50C of the Act does not come into operation where leasehold rights in land are transferred?".*

9.7 The Bombay High Court in the case of ***Pr. CIT vs. Kancast Pvt. Ltd. (supra***) has, while admitting the substantial question of law, observed that *"at the time when* *an appeal against the decisions in Greenfield **Hotels and Estates [2016 (12) TMI 353 – Bombay High Court]** and **Heatex Products Pvt. Ltd. [2016 (7) TMI 1393** - Bombay High Court] were not entertained by this Court, the decision of this Court in **Pradeep Steel Re-Rolling Mills Pvt. Ltd. [2011 (7) TMI 1101 - ITAT MUMBAI]** admitting the appeal on this very question was not brought to our notice."*

9.8 Also, the Bombay High Court, in the case of ***Keki Bomi Dadiseth vs. CIT [2017 (3) TMI 1055 – Bombay High Court],*** was dealing with objection of the assessee to the action of the AO in reopening the assessment. The assessee contended that in view of the decision of the Bombay High Court in **Greenfield Hotels & Estates (P) Ltd. (supra)**, the AO could not have reason to believe that the income chargeable to tax has escaped assessment, the Court held as under –

*"So far as the submission on behalf of the petitioner that the Assessing Officer could not have any reason to believe that income chargeable to tax has escaped assessment in view of the decision of this Court in **Greenfield Hotels & Estates (P) Ltd. (2016 (12) TMI 353 - Bombay High Court)** is concerned, it is observed that the aforesaid decision of this Court did not independently rule appropriate interpretation of Section 50C of the Act. The Court refused to entertain the Revenue's appeal for the reason that the impugned Order of the Tribunal had followed its earlier decision in case of **Atul G. Puranik vs. ITO [2011 (5) TMI 576 - ITAT, Mumbai].** The Revenue had accepted the same and in appeal from the Order of the Tribunal in **Atul G. Purnaik (supra)** was preferred. In the aforesaid background the Court refused to interfere with the Order of the Tribunal as there were no distinguishing features either on facts or in law as reiterated in **Green field Hotels & Estates (P) Ltd. (supra)** from that existing in **Atul G. Puranik (supra)**.*

In the present facts, the petitioner had not brought any decision of the Tribunal on the issue of law while filing its objections which the Assessing Officer could have dealt with bearing in mind facts involved. –Decided against assessee."

9.9 Further, in the case of ***Sh. Ram Ji Lal Meena s/o Sh. Bachu Ram Meena vs. ITO, Jaipur [2018 (5) TMI 1792 - Rajasthan High Court]*** when the appellant referred judgment of Bombay High Court in ***M/s. Greenfield Hotels & Estates Pvt. Ltd. [2016 (12) TMI 353 - Bombay High Court]*** and submitted that in this case it has been held that Section 50C of the Act of 1961 would not be applicable on transfer of lease hold rights of the land, the Rajasthan High Court held that – *"Bare perusal of Section 50C of the Act of 1961 does not show that transfer of capital asset for consideration should be other than of leasehold property or khatedari land. The court cannot re-write the provision. If analogy taken by the Bombay High Court in the case (supra) is applied in general then Section 50C would not be applicable in majority of the cases as it is not allowed as leasehold property. Section 50C is applicable to transfer of capital assets for consideration. The Bombay High Court has not referred as how the land was in the balance-sheet. It is as a capital asset or not thus we are unable to apply the judgment of Bombay High Court in the case of **M/s. Greenfield Hotels & Estates Pvt. Ltd. (supra)**."*

9.10 In view of what has been stated hereinabove in paragraphs 9.6 to 9.9, one will have to bear in mind a potential risk of litigation in the event the capital gains are chargeable and the consideration as per the agreement is less than the stamp duty value of the development rights transferred.

10 Cash compensation received by an assessee, a member of housing

society, from a developer pursuant to development agreement entered into by the society with the developer is a capital receipt not chargeable to tax.

10.1 In the case of ***Kushal K. Bangia vs. ITO [(2012) 50 SOT 1 (Mum.)],*** the assessee, a member of a housing society, received a sum of ₹ 11,75,000 from the developer as what was termed as cash compensation. This sum was over and above the sum of ₹ 6,12,000 being displacement compensation calculated @ ₹ 34,000 per month. The monetary compensation was in addition to a larger flat being given. The AO held that the cash compensation was a revenue receipt and charged it to tax under the head Income from Other Sources. He also charged to tax value of the incremental area received by the assessee. CIT(A) gave relief to the assessee as far as value of incremental area is concerned and revenue did not challenge the order of CIT(A) and therefore, that part of addition made by AO was not before the Tribunal. As regards the cash compensation, the Tribunal held it to be a capital receipt which will go to reduce the cost of the asset concerned and while computing capital gains arising on sale the reduction in cost of acquisition will have to be effected. The Tribunal held as under –

"In our considered view, it is only elementary that the connotation of income howsoever wide and exhaustive, take into account only such capital receipts are specifically taxable under the provisions of the Income-tax Act. Section 2(24)(vi) provides that income includes "any capital gains chargeable under section 45", and, thus, it is clear that a capital receipt simplicitor cannot be taken as income. Hon'ble Supreme Court in the case of ***Padmaraje R. Kardambande vs. CIT [1992] 195 ITR 877/62 Taxman 456*** *has observed that "., we hold that the amounts received by the assessee during the financial years in question have to be regarded as capital receipts, and, therefore, (emphasis supplied by us), are not income within meaning of section 2(24) of the Income-tax Act." This clearly implies, as is the settled legal position in our understanding, that a capital receipt in principle is outside the scope of income chargeable to tax and a receipt cannot be taxed as income unless it is in the nature of revenue receipt or is brought within the ambit of income by way of a specific provision in the Act. No matter how wide be the scope of income u/s. 2(24) it cannot obliterate the distinction between capital receipt and revenue receipt. It is not even the case of the Assessing Officer that the compensation received by the assessee is in the revenue field, and rightly so because the residential flat owned by the assessee in society building is certainly a capital asset in the hands of the assessee and compensation is referable to the same. As held by Hon'ble Supreme Court, in the case of* ***Dr. K. George Thomas vs. CIT [1985] 156 ITR 412/23 Taxman 46,*** *"the burden is on the revenue to establish that the receipt is of revenue nature" though "once the receipt is found to be of revenue character, whether it comes under exemption or not, it is for the assessee to establish". The only defence put up by learned Departmental Representative is that cash compensation received by the assessee is nothing but his share in profits earned by the developer which are essentially revenue items in nature. This argument however proceeds on the fallacy that the nature of payment in the hands of payer also ends up determining its nature in the hands of the recipient. As observed by Hon'ble Supreme Court in the case of* ***CIT vs. Kamal Behari Lal Singha [1971] 82 ITR 460,*** *"it is now well settled that, in order to find out whether it is a capital receipt or revenue receipt, one has to see what it is in the hands of the receiver and not what it is in the hands of the payer". The consideration for which the amount has been paid by the developer are, therefore, not really relevant in determining the nature of receipt in the hands*

of the assessee. In view of these discussion, in our considered view, the receipt of ₹ 11,75,000 by the assessee cannot be said to be of revenue nature, and, accordingly, the same is outside the ambit of income under section 2(24) of the Act. However, in our considered opinion and as learned counsel for the assessee fairly agrees, the impugned receipt ends up reducing the cost of acquisition of the asset, i.e. flat, and, therefore, the same will be taken into account as such, as and when occasion arises for computing capital gains in respect of the said asset. Subject to these observations, grievance of the assessee is upheld."

11 Are the amounts received by members towards rent for alternate accommodation, brokerage, shifting expenses, inconvenience allowance taxable in their hands? If yes, is the taxability the same irrespective of whether the property is a residential property or a commercial property

11.1 While the existing building of the society is demolished and the new building is being constructed the members of the society who are in occupation of the flats/ units need to move out and also incur expenditure on rent, brokerage and shifting. In order to enable the members to do this, the developer pays certain fixed amounts to the members so as to enable him to meet these costs. The amount is fixed considering the rent prevailing in the neighbouring area and also the area of the flat in which the member who is shifting was staying. Such moving out inconveniences the member significantly. In some cases, the developer also pays `Inconvenience Allowance' to the member. A question arises about taxability of these amounts received by the member from the developer.

11.2 If a view is taken that the amounts referred to in above paragraph constitute a revenue receipt which is taxable the next question which requires consideration is whether the amounts incurred towards rent, shifting expenses, brokerage, etc. are deductible from these amounts as the very purpose of receiving these amounts is to meet specific items of expenditure.

11.3 The amount of rent for alternate accommodation, inconvenience allowance, shifting expenses are not `income' as is understood by the dictionary meanings of this term. It is not covered by any of the specific sub-clauses of Section 2(24) of the Act. The submission therefore is that these amounts are capital receipts. Capital receipts are chargeable to tax only under the head 'capital gains'. This would happen if they are consideration in connection with transfer of a capital asset. The contention that these amounts are received in connection with transfer of a capital asset and therefore form part of full value of consideration for computing capital gains is not an entirely baseless contention.

11.4 The Mumbai Bench of the Tribunal in the case of ***ITO vs. Harsha Jitendra Sanghvi [ITA No. 6732/Mum./2012; AY: 2008-09 decided in MA No. 15/Mum./2017 vide Order dated 9-8-2017]*** rejected the contention of the assessee that the amount received from developer towards rent for alternate accommodation is not taxable on the ground that, in the facts of this case, the assessee had not incurred any amount and the Tribunal went on to observe that even if the amount was incurred it would amount to application of income. The Tribunal, accepted the alternate contention made on behalf of the assessee viz. that the amount is received in connection with transfer of property and therefore, the amount received for the said purpose is nothing but a part and parcel of the total consideration for transfer of property.

11.5 While the contention of the assessee always is that these payments are capital receipts, the Assessing Officers contends that these amounts constitute revenue receipts chargeable to tax under the head 'Income from Other Sources'. In such a case, question of allowability of expenditure incurred also becomes a subject matter of dispute.

11.6 The Madras High Court in the case of ***P. Madhusudhan vs. ACIT [(2019) 109 taxmann.com 103 (Mad.)]*** held that payments received by assessee on account of rent free accommodation could not be included to income of assessee as long term capital gains.

11.7 Pune Bench of the Tribunal has in the case of ***Dr. Arvind S. Phadke vs. Addl CIT [(2014) 46 taxmann.com 335 (Pune - Trib.)]*** has held that rent paid by builder towards alternate accommodation given to assessee land owner in course of business activity, could not be held as part of consideration paid to assessee for transfer of assets. The Tribunal held that "the taxability of the aforesaid sum has to be seen as a part and parcel of the transaction resulting in assessee getting possession of the constructed tenement from the developer. Ostensibly, there is no justification for the revenue to say that it is a revenue receipt because it is nobody's case that the arrangement with the developer undertaken by the assessee is in the course of any business activity."

11.8 However, in the case of ***Jatinder Kumar Madan vs. ITO [(2012) 21 taxmann.com 316 (Mum.-Trib.)],*** the assessee, existing flat owner, received, as per development agreement, certain amount of compensation from builder for alternate accommodation. During the period of construction of building the assessee received ₹ 7,01,460 and after deducting rent paid by the assessee during the period of construction, net amount of ₹ 2,05,766 had been taxed by the AO as income from other sources. The Tribunal noted that displacement compensation was not related to any capital asset rather it was paid in connection with alternate accommodation given to assessee to facilitate construction of flat. The Tribunal held that having regard to fact that actual rent paid by assessee for alternate accommodation was lower than amount received net income of assessee was rightly taxed as `Income from Other Sources'.

11.9 Similarly, the Pune Bench of the Tribunal has in the case of ***Parag Hanumant Tambe vs. ITO [ITA No. 1518/Pun./2017; A.Y. 2013-14; Order dated 22-10-2018]*** while observing that there is merit in the plea of the assessee that the said amount is reimbursement of rent paid and not taxable in his hand, however, held that the balance cash reimbursement, if any, is to be added in the hands of the assessee as his income for the year.

11.10 When rent is received by a Member of the society in respect of a commercial property occupied by him for the purposes of his business, the amount of rent so received will be regarded as a revenue receipt. In such a case, it will be comparatively more difficult to contend that the amount being received is a capital receipt not chargeable to tax. Undoubtedly, the rent for the alternate premises taken will be allowed as a deduction while computing the income under the head `Profits & Gains of Business or Profession'. However, the case of an assessee using the property for the purposes of his own business would stand on a different footing as compared to case of an assessee who owns a commercial property and is holding it as an investment or is renting it out and the income of such property is being charged to tax under the head 'Income from House Property'.

12 Is the value of additional area received by the member, free of cost from the developer, taxable in his hands? If yes, under which head of income and how does one compute the value? Can a member who is an individual/HUF claim exemption under Section 54?

12.1 Under the terms of Permanent Alternate Accommodation Agreement entered into by a member with the developer read with the Development Agreement entered into by the parties, a member of a society is generally entitled, free of cost, to a flat/unit bigger in area than the one presently occupied by him. A question arises as to whether there is a transfer of an old flat/unit in lieu of new flat/unit giving rise to capital gains in the hands of the member. The answer obviously is in the affirmative. However, if the member is an individual or a Hindu Undivided Family and the property is a residential house then whatever be regarded as the value of the new flat (being full value of consideration for the purposes of computing capital gains arising on transfer of the old house/unit) the same will qualify as amount utilised for construction of a new residential house and will be exempt under section 54 of the Act.

12.2 In the event that the developer does not complete the construction within a period of three years from the date of transfer of old property, a question may arise as to whether the exemption under section 54 of the Act can be denied. This, however, could be defended by relying on the judicial precedents wherein it has been held that the assessee cannot be penalised if the delay in completion is for reasons beyond the control of the assessee.

12.3 The case may, however, be doubtful where at the inception the assessee was aware that the construction will not be completed within three years but even on this issue there are decisions to the effect where the claim for exemption under section 54 has been allowed.

12.4 In case the member is not eligible to claim exemption under section 54 (because he is not an individual or a Hindu Undivided Family or because the income of the residential house transferred by him was not chargeable to tax under the head 'Income from House Property') is not then for the purposes of computing capital gains arising on transfer of the old flat the value of the new flat to be received will be regarded as full value of consideration.

12.5 A question could arise as to whether the stamp duty value of the new flat can be considered to be the full value of consideration or would the assessee/AO be justified in adopting a value different from the stamp duty value of the new flat.

12.6 While the stamp duty value would be indicative of the market value of the flat to be received, however, strictly speaking, the law does not mandate adopting the stamp duty value of the new flat to be received to be full value of consideration for the purpose of computing capital gains arising to the member on transfer of the old flat and therefore, it would be open both for the assessee as well as the AO to adopt a value different from the stamp duty value of the new flat to be its full value of consideration for the purpose of computing capital gains arising on transfer of old flat.

12.7 Different consequences will flow if the property is a used by the member of the society for the purposes of his business or profession profits whereof are chargeable to tax. Consequences if the property is a commercial property/property which is used by the members for the purposes of his business or profession profits whereof are chargeable to tax are discussed in subsequent paragraph.

13 Tax consequence in the event the property is a commercial property

13.1 Cases of a member holding a property in a society which is a commercial property and/or a property which is used by a member for the purposes of business or profession carried on by him could be classified into three categories viz.-

(i) the member is not occupying the property for the purpose of his business or profession profits of which are chargeable to tax. In other words, the commercial property is held by the member for renting/investment and the rental income is charged to tax under the head 'Income from House Property';

(ii) the member is occupying the commercial property for the purposes of his business or profession profits of which are chargeable to tax and this commercial property is the only item in the block of assets; and

(iii) the member is occupying the commercial property for the purposes of his business or profession the profits of which are chargeable to tax and this commercial property is one of the properties in the block of assets.

13.2 Consequences in each of the above referred three situations will be as under –

(i) In a case where the commercial property is held by a member for renting/investment and the rental income is charged to tax under the head 'Income from House Property', capital gains will be charged to tax in the hands of the member by considering the value of the new premises to be full value of consideration. This consequence is the same as that if the property was a residential property except that in this case the member will not be entitled to claim exemption under Section 54 of the Act (because the property transferred is not a residential house). Benefit of exemption under Section 54EC/ Section 54F will, however, be available subject to satisfaction of the conditions mentioned in these sections.

(ii) In a case where the commercial property is held by the member for the purpose of his business or profession and this is the only item in the block of assets then upon the assessee transferring this commercial property (on giving possession thereof to the developer) the block will cease to exist and the gains will have to be computed and charged to tax in accordance with the provisions of Section 50 of the Act;

(iii) In a case where the commercial property is held by the member for the purposes of his business or profession and this is one of the assets in the block of assets then it appears that, though unintended, there will be no tax consequence. This is because depreciation is allowed on the written down value of the block. 'Written down value' is defined in section 43(6)(c) of the Act. According to Sec. 43(6)(c)(B) the block can be reduced only to the extent of "moneys payable" in respect of any asset within that block which is sold or discarded or demolished or destroyed during the previous year together with the amount of the scrap value, if any. In this case, where the assessee receives new commercial premises (which are bigger than the old premises) in lieu of old premises there are no "moneys payable" and therefore, the question of any reduction from the block does not arise. Similarly, on receiving the new commercial premises, there will be no addition to the block because as per Section 43(6)(c)(i)(A) addition to the block can be only by actual cost of any asset falling within that block, acquired during the previous year. The term "actual cost" is defined in Section 43(1). In view of the said definition, it appears, that there will be no adjustment to the block.

14 Applicability of provisions of section 56(2)(x) on receipt of additional areas, over and above their entitlement, for a consideration which is lower than the price at which the developer is selling to outsiders

14.1 When a person receives an immovable property (being land or building or both) for a consideration which is less than its stamp duty value and the difference between the stamp duty value of the immovable property received and the amount of consideration is more than the amounts specified in section 56(2)(x) then the difference is chargeable to tax as income under the head `Income from Other Sources'.

14.2 In a scheme of redevelopment, society negotiates with a developer that in case any of the members of the society desire to purchase from the developer additional areas (over and above their entitlement) the developer shall sell the additional areas to the members at an agreed rate which is less than the rate at which the developer would sell the areas to outsiders (non-members). If such agreed rate happens to be lower than the stamp duty value, question of applicability of the provisions of section 56(2)(x) would arise. While on a plain reading it would appear that the provisions of section 56(2)(x) would be attracted and the difference between the stamp duty value of the additional area and the consideration paid by the member to acquire the additional area (at the agreed rate) would be taxable under the head 'Income from Other Sources' it should be an arguable case to contend that in such a situation the provisions of section 56(2)(x)(b)(B) do not apply since what is contemplated is comparison of the consideration with the stamp duty value. When a member of the society acquires additional areas, the consideration for acquiring the additional area, in this case, is not merely a monetary consideration but the monetary consideration is only one part of the consideration. The monetary consideration agreed was fixed as a part of a composite redevelopment transaction pursuant to which the member is even inconvenienced while the construction of new building is under progress, the member has agreed to co-operate in the redevelopment being undertaken by the developer, the member is a member of the society which has permitted redevelopment, etc. The provisions of section 56(2)(x) will not apply to such consideration which cannot be evaluated in monetary terms. Following the ratio of the decision of the Mumbai Bench of the Tribunal in the case of ***Purvez A. Poonawala vs. ITO [(2011) 138 TTJ 673 (Mumbai)]*** it can be argued that the provisions of Section 56(2)(x) will not be applicable to such a case.

15 Are damages received for breach of development agreement taxable?

15.1 The Development agreement/permanent alternate agreement entered into by the society and/or its members with the developer would generally provide for the time of completion of construction of the new building by the developer. The development agreement would also provide that upon the failure of the developer to comply with his obligations under the development agreement, he would be liable to pay damages as may be mentioned in the development agreement. Upon there being a breach by the developer to perform his obligations under the development agreement, he may pay the amount of damages specified in the development agreement. Upon receipt of damages, the question of taxability of the amount of damages received by the society/members from the developer arises.

15.2 Madras High Court, in the case of ***P Madhusudhan vs. ACIT [(2019) 109 taxmann.com 103 (Mad.)],*** has held that damages paid by the developer to assessee on account of non-fulfilment of condition in agreement with regard to time limit of handing possession of constructed area could not be added as income in hands of the assessee on account of capital gains on transfer.

15.3 In the case of ***P. Madhusudhan vs. ACIT (supra),*** the assessee, owner of land, entered into a development agreement with a developer wherein assessee transferred certain areas of land to developer and in return developer agreed to build and handover certain percentage of built up area on said land to assessee. Developer handed over built-up area to assessee after a delay. On account of such delay, assessee was paid damages of certain amount as agreed in development agreement. AO added said damages received by the assessee to income of assessee as long term capital gains under section 45. The Court held that the damages paid by developer to assessee on account of non-fulfilment of condition in agreement with regard to time limit of handing possession of constructed area could not be added as income in hands of assessee on account of capital gain on transfer.

16 Conclusion

Above are some of the issues which are likely to arise in taxation of a transaction of re-development of a property by a society. In a real life scenario, considering the facts of each individual case there could be several other issues. Some of them being cancellation of development agreement, sale by a member of the new flat acquired by him such sale happening while the construction is still not complete or such sale happening soon after the member receives possession of the new flat/unit. Date from which holding period of the new flat/unit commences could be another area where more than one view could be possible.

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Income from House Property

CA Ketan Vajani

Issues arising on account of Taxation of Immovable Properties have always been challenging and also of *vide* variety. The tax issues arise at all stage of transactions in immovable properties, be it acquisition, holding, leasing and also transfer of the properties. Considering the relevance of the topic, the Journal Committee of The Chamber has rightly taken up this as a subject for the special story for the month of January, 2020.

As we are aware, the Rent Income earned by the owner of the properties is assessed to tax under the provisions of sections 22 to 27 falling under Chapter IV-C- "Income from House Property" under the Income-tax Act, 1961. Though the chapter is a small chapter consisting of only six sections, the issues that arise out of these six sections are large also resulting in protracted litigation which have travelled right up to Supreme Court time and again. This article seeks to deal with some of such contemporary issues and attempts to understand the issues in light of the legal principles and judicial views available on the subject.

Sub-section (4) of Section 23 of the Income-tax Act and amendment made by Finance Act, 2019

Section 23 of the Act provides for computation of Annual Value in respect of a House Property. Sub-section (2) of the section provides that the annual value in respect of a house property which is in the occupation of the owner for the purposes of his own residence or which cannot be actually occupied by the owner where owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him, shall be taken at NIL. This is commonly known as Self Occupied Property – SOP.

Sub-section (4) of section 23 further provides that where the property consists of more than one house, then only one house will be treated as SOP at the option of the assessee and the annual value in respect of other house or houses will be determined by treating them as deemed to have been let out. Finance Act, 2019 made an amendment to sub-section (4) of section 23 so as to permit two houses being treated as SOPs instead of one such house w.e.f. A.Y. 2020-21. As such, with effect from A.Y. 2020-21, the owner will be allowed to have two houses as SOP and the provisions of deemed to be let out will apply only where the owner owns more than two residential houses. The amendment is a welcome amendment since it recognises the need of the present day situation where many assessees have two houses where the second house is in the form of a holiday home or vacation home.

Whether the Nil value of SOP can also be available to HUF?

An interesting issue arises out of sub-sections (2) and (4) as to whether the benefit of Self Occupied Property i.e. SOP is available to only individuals or that a HUF can also avail such benefit of one/two houses being treated as SOP? On reference to the language of sub-section (2), it apparently feels that the benefit is available only to individual assessee and not to HUF. This is because, the sub-section talks about the house being in the occupation for his own residence or the house being not occupied due to his employment, business or profession etc.

However, here it is pertinent to note that as per section 13 of the General Clauses Act, the words in masculine gender shall be taken to include females and words in singular shall include plural and *vice versa*. Accordingly, the word 'owner' would include *'owners'* and the words '**his own**' would include *'their own'*. There is nothing, therefore, in the words used in Section 23(2), which excludes application of such provision to HUF, which is a group of individuals related to each other. The Delhi Bench of the Income-tax Appellate Tribunal in the case of ***ITO vs. Tarlock Singh & Sons (1989) 29 ITD 139 (Del.)*** has recognised the provisions of section 13 of the General Clauses Act and held the issue in favour of the assessee.

Further, the Gujarat High Court, while dealing with the provisions of section 7(4) of the Wealth-tax Act, 1957, which is akin to section 23(2) of the Income-tax Act, in the case of ***CWT vs. Ashok Raje Gaekwad (2004) 267 ITR 54 (Guj.)*** held that an HUF can claim one house as self-occupied house for the purpose of section 7(4) of the Wealth-tax Act. Later the full bench of the Hon. Gujarat High Court in the case of ***CIT vs. Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj.),*** specifically dealing with the provisions of section 23(2) of the Act, followed its earlier decision in ***Ashok Raje Gaekwad (supra)*** and held that the benefit of SOP can be available to HUF in respect of one of the house which can be treated as SOP. The Gujarat High Court has held in this case that a Hindu Undivided Family is nothing but a group of individuals related to each other by blood relations, or in a certain manner. An Hindu Undivided Family can be seen being a family of a group of natural persons. There is no dispute that the said family can reside in the house, which belongs to Hindu Undivided Family.

On account of the amendment made by the Finance Act 2019, HUF will now be permitted to treat two houses as SOP and take the benefit of NIL as the annual value of such houses. This will be a big relief in cases where due to the size of family or various other social factors, the family has two separate houses and some of the members of the HUF are staying in each such house.

However, as a word of caution, one must also appreciate that though the section 23(2) talks about an owner and not any particular form of the assessee, the section will not be applicable to other artificial persons like firms, companies etc since the partners of the firm or share-holders of a company need not necessarily be relatives and therefore the ratio of the above decision of the Gujarat High Court has to be confined to HUFs and cannot further be extended to firms or companies.

How to determine Annual Value in case of Deemed Let out Property ?

As stated above, sub-sections (2) and (4) of section 23 provide that if the owner owns more than two properties then two of the properties will be treated as Self-occupied property for the purpose of residence and the other property or properties will be treated as deemed let out property. Similarly, if the assessee owns a commercial property, which is not actually let out but lying vacant, the same will still have to be treated as deemed let out property for the purpose of computation of Income from House Property. If, however, any property is used for the purpose of business or profession of the assessee, then section 22 itself carves out such property and no annual value needs to be computed for such property.

The Annual value of deemed let out properties will be made as per the provisions of clause (a) sub-section (1) of section 23 of the Act. Clause (a) of the sub-section reads as under :

"For the purposes of section 22, the annual value of any property shall be deemed to be –

(a) the sum for which the property might reasonably be expected to let from year to year ; or ….

(b) …..

(c) …."

The phrase relevant for the purpose of clause (a) i*s "the sum for which the property might reasonably be expected to let from year to year"*. This phrase is very subjective in nature and it depends on personal perception for each individual. Thankfully though, there are some broad guidelines available as regards interpretation of this phrase which reduces the subjectivity of the phrase considerably.

Some of the relevant terms which one needs to bear in mind while arriving at the valuation u/s. 23(1)(a) are explained hereunder :

- *Municipal Value* : Municipal Value is that value of the property which Municipal Authorities deem as the estimated annual rent of the property for the purpose of assessment of property tax.
- *Fair Rent :* The rent which is fetched by a similar property in same or similar locality having similar infrastructure and facilities is known as Fair Rent.
- *Standard Rent* : Rent which is the maximum rent which a person can recover from the tenant under the Rent Control Act is known as Standard Rent.
- *Municipal Taxes* : The taxes levied by any local authority in respect of the property is known as Municipal Taxes in common parlance.

For arriving at the annual value of the property, one needs to first check whether the property is covered by the Rent Control Act or not. If it is covered by the Rent Control Act, one will need to get the Standard Rent i.e., the maximum permissible Rent under the said Act which can be charged from the tenant. Having decided about the applicability or non-applicability of Standard Rent, one will then need to evaluate the municipal value and fair rent of the property.

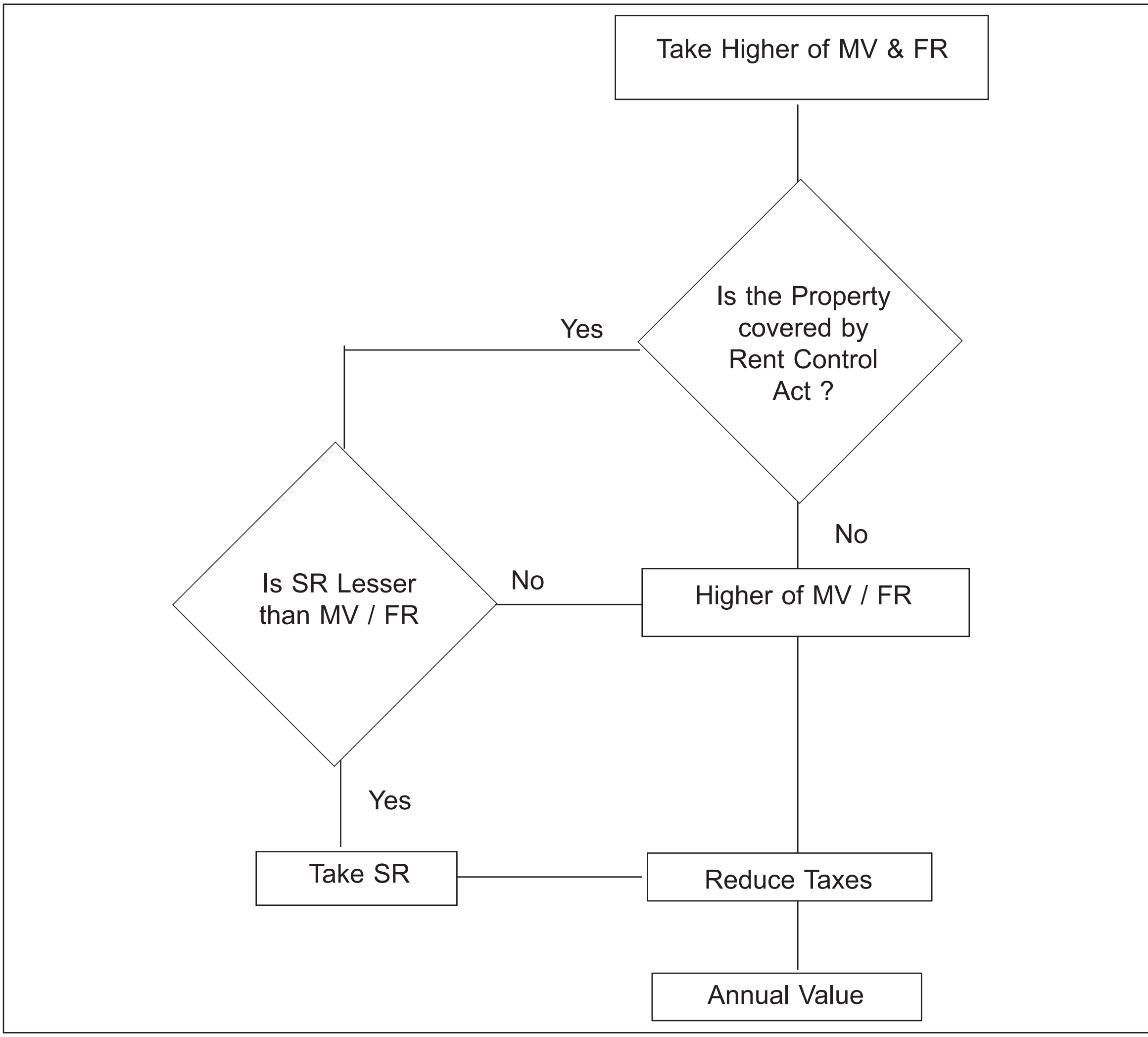
If the Municipal Value of the property is higher than the Fair Rent, then the same has to be compared to Standard Rent. If it is lesser than the Standard Rent, then such Municipal Valuation will be treated as Annual Value. However, if it is more than the Standard Rent, then the Standard Rent will be treated as Annual Value.

If the Municipal Value of the property is lesser than the Fair Rent, then Fair Rent has to be compared to Standard Rent. If it is lesser than the Standard Rent, then such Fair Rent will be treated as Annual Value. However, if it is more than the Standard Rent, then the Standard Rent will be treated as Annual Value.

Here it is relevant to note that by definition Standard Rent is the Maximum Rent which can be recovered from a tenant under the provisions of Rent Control Act. Therefore, in no case the Annual Value can exceed the Standard Rent even if the Municipal Value or the Fair Rent is arithmetically higher than Standard Rent.

The proviso to sub-section (1) also provides that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year to which the taxes pertain) in determining the annual value of the property of the previous in which such taxes are actually paid by the assessee. As such, the taxes are allowed to be reduced while computing the annual value purely on the payment basis and the year to which the taxes pertain is not relevant at all.

The provisions of section 23(1)(a) can be easily understood by way of a flow-chart as under :



Whether Notional Interest can be considered for the purpose of determination of Annual Value

One of the frequently faced questions in the subject is whether the Notional Interest can be added while determining the Annual Value of the Property. In a case where the assessee receives a huge amount of interest free deposit from the tenant and charges very nominal rent for the property, whether the interest on such deposit can be added to the Annual value of the property? The question is a frequently asked question but the answer seems to be a settled position. As per the decision of the Hon. Bombay High Court in the case of ***CIT vs. J. K. Investors (Bombay) Ltd. (2001) 248 ITR 723 (Bom.);*** such notional amount cannot be added to the amount of Annual Value in a case where the annual value is determined u/s. 23(1)(b) i.e., where the actual rent is admittedly more than the fair rent.

If, however, the actual rent is less than the fair rent and the amount of annual value is determined u/s. 23(1)(a) of the Act, the assessing officer will have the powers to make due investigation especially where there are suspicious facts leading to belief that the rent is deflated by reason of extraneous considerations – Ref : C***IT vs. Tip Top Typhography (2014) 368 ITR 330 (Bom.); CIT vs. Moni Kumar Subba (2011) 333 ITR 38 (Del.)***

Vacancy Allowance

Section 23(1)(a) of the Act provides for determination of annual value. The same has been discussed in detail above. Section 23(1)(b) provides that where the property or any part of the property is actually let out and the actual rent received or receivable is higher than the value determined u/s. 23(1)(a) of the Act, then such actual rent will be treated as annual value.

A situation might arise where the property is actually let during the year but remained vacant for some part of the year or even for the entire year for various reasons. To address such a situation, clause (c) of section 23(1) provides that where the property or any part thereof is let and was vacant during the whole or any part of the previous year and owing to such vacancy, the actual rent received or receivable is less than the annual value determined in accordance with clause (a), the amount so received will be treated as Annual Value.

On plain reading of the clause (c), it is clear that the clause is applicable where:

- The property or any part thereof is **actually let**;
- The property was vacant during the **whole or any part** of the previous year:
- Owing to vacancy **the actual rent received or receivable is less than amount determined under clause (a).**

There cannot be any doubt as regards whether the property was actually let or not. If the property was not let out, then the clause (a) will only be relevant and there will not be any possibility to have any figure under clauses (b) and (c). However, on further reading one can see that the benefit of clause (c) can be availed where the property is actually let but was vacant during the whole or any part of the previous year.

If the property is vacant for a part of the previous year, then there cannot be much of difficulty in application of clause (c) and the same will apply without any doubt. However, controversy arises where the property is remaining vacant for the entire financial year.

Whether benefit of Vacancy Allowance can be claimed where the property is not let during the entire financial year?

A doubt arises as to what will be the situation where the property is actually let in the earlier years but during the relevant financial year, the property has remained vacant for the entire year for various reasons. Can one contend that the property was covered by clause (c) and applying the manner of computation provided in clause (c), actual amount received or receivable is NIL which is less than the amount determined under clause (a) and hence the amount of annual value is NIL? The department will, however, argue that in such a situation since the property is not actually let, clause (c) will not apply and the annual value will have to be determined under clause (a).

On plain reading of the clause, it seems that in such a situation clause (c) will be applicable. It is relevant to note that though the clause talks about the property being let out, there is no condition that the same must have been let out during the financial year. In fact, the clause specifically talks about the property being vacant for **whole or any part of the year** and as such on first reading it appears that the benefit of clause (c) can be available in such a situation.

The Mumbai bench of the Income-tax Appellate Tribunal in the case of ***Premsudha Exports Pvt. Ltd. vs. ACIT (2008) 110 ITD 158 (Mum.)*** has accepted the above contention of the assessee and held that if the property is held by the owner for letting out and efforts were made to let it out, that property is covered by this clause. Further it held that this requirement has to be satisfied in each year that the property was being held to let out but remained vacant for whole or part of the year. The Tribunal observed that the words *'property is let'* are used in this clause to take out those properties from the ambit of the clause in which properties are held by the owner for self-occupation i.e., Self-Occupied property (i.e SOP) because even income on account of SOP, excluding one such SOP of which annual value is to be adopted at nil, is also to be computed under clause (a) of section 23(1). While deciding the issue, the Tribunal also noticed the difference in the language of section 23(3) where the words used are *'actually let'* as against clause (c) of section 23(1), where the words used are 'property is let'.

The above decision of the Hon. Tribunal has been followed by various later decisions to hold that as long as the property is intended to be let out and there are efforts on the part of the assessee to let it out, the assessee will get the benefit of clause (c) of section 23(1). Useful reference for this purpose can be made to the decisions in the cases of ***ITO vs. Metaoxide P. Ltd. (2018) 170 ITD 234; Sachin R. Tendulkar vs. DCIT 172 ITD 266 (Mum.); Saif Ali Khan Pataudi vs. ACIT (2018) 172 ITD 345 (Mum.).***

However, one also needs to take a note of the contra decisions on the subject. The Hon. Andhra Pradesh High Court in the case of ***Vivek Jain vs. Asst. CIT (2011) 337 ITR 74 (AP)*** has held that clause 23(1)(c) would apply only if all the three conditions listed therein are satisfied. The Court held that clause (c) does not apply to situations where the property has either not been let out at all during the previous year or, even if let out, was not vacant during the whole or any part of the previous year. The construction placed on s. 23(1)(c), by the assessee that if there is an intention to let out the property during the relevant year, coupled with efforts being made for letting it out, it must be held the property is let, would necessitate reading words into s. 23(1)(c) which do not exist. The words *"where the property is let"* cannot be read as *"where the property is intended to be let"* since such construction will take all the properties out of ambit of clause (a) of the sub-section.

Further while dealing with the argument that clause (c) provides for an eventuality where a property can be vacant during the whole of the relevant previous year, the Hon. High Court held that the contention of the assessee that both situations, i.e., *"property is let"* and *"property is vacant for the whole of the relevant previous year"* cannot co-exist does not merit acceptance. According to the High Court, clause (c) encompasses cases where a property is let out for more than a year in which event alone would the question of it being vacant during the whole of the previous year arise. A property let out for two or more years can also be vacant for the whole of a previous year bringing it within the ambit of cl. (c) of s. 23(1).

The High Court also held clearly that there is no merit in the submission that the words *"property is let"* are used in clause (c) to take out those properties which are held by the owner for self-occupation from the ambit of the said clause in as much as s. 23(2)(a) provides for such an eventuality. The purpose of clause (c) is only to mitigate the hardship faced by an assessee, where the property is let and, because of vacancy, the actual rent received or receivable by the owner is less than the sum referred to in clause (a). In cases where the property has not been let out at all, during the previous year under consideration, there is no question of any vacancy allowance being provided thereto under s. 23(1)(c).

The Hon. Punjab and Haryana High Court in the case of ***Susham Singla vs. CIT (2017) 244 Taxman 302 (P & H)*** has also adopted similar view of the matter. The High Court has held in this case that the annual value of the properties which are more than one, owned by the assessee and which remained vacant throughout the previous year would not be assessed under section 23(1)(c) but under section 23(1)(a). It is also relevant to note that the SLP of the assessee against this decision has been dismissed by the Honourable Supreme Court by observing that *"We do not find any merit in this petition"*. Ref. : ***Susham Singla vs. CIT (2017) 247 Taxman 312 (SC).***

As such, one will have to be cautious about the above two decisions of the High Courts while deciding about the applicability of the relevant clause. It is also to be noted that none of the decisions of the Tribunal discussed hereinabove have referred to the decisions of the High Courts of Andhra Pradesh and also Punjab & Haryana. The High Court being a higher judicial forum, its decision will have binding precedent as compared to the decisions of the Tribunal discussed above.

However, as a matter of silver lining one can also refer to the decisions of the Tribunal in the cases of ***Informed Technologies India Ltd. vs. Dy. CIT (2017) 162 ITD 153 (Mum.)*** and also ***Vikas Keshav Garud vs. ITO (2016) 160 ITD 7 (Pune).*** Both these decisions of the Tribunal have considered the decision of the Andhra Pradesh High Court in the case of Vivek Jain and have distinguished the case on facts of its case. In both these cases, the properties have been actually let in the earlier years and it was only during the respective previous year that the properties have remain vacant. The Tribunals have allowed the claim of the assessee on the basis of this fact and have observed that the decision of the Andhra Pradesh High Court has to be read in the manner that where the property has actually been let in prior years but the same was vacant only during the current previous year, benefit of section 23(1)(c) has to be allowed to the assessee.

Considering the above discussion, it seems that the decision of the Andhra Pradesh High Court will be going against the assessee in a case where the property was never let out as a matter of fact and the assessee is trying to still argue that it is intended to be let out. However, where the property was let out at some point of time for a reasonable time frame and was vacant during the previous year despite some genuine attempts on the part of the assessee to let it out, it will be possible to claim benefit of section 23(1)(c) of the Act.

Conclusion

The taxability of Income from House Property is a very interesting subject. The same is challenging as well since the section provides for ultimate taxing a notional income under section 23(1)(a) and therefore, the assessee will never like to be taxed on such notional income and will try to find some escape route for sure. Though the escape route is not *per se* available, one can have the benefit of vacancy allowance as provided under section 23(1)(c) subject of course to the condition that the facts support it.

I am extremely thankful to the Journal Committee for giving me this wonderful opportunity to deal with this interesting and challenging subject. This assignment has enabled me a chance to revisit some of the fundamental concepts on the subject and correct some of the myths prevalent in my mind. I have been more enlightened on controversies around the subject and certainly the first and the largest beneficiary in the process.

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Exemptions



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I. INTRODUCTION

"If you sell your house to make a profit, pay Caesar what is due to him. But, if you buy or build another, subject to the conditions of section 54(1), you are exempt." These words of Justice V. R. Krishna Iyer (as His Lordship then was) in the decision of the Hon'ble Supreme Court in the case of ***CIT vs. T. N. Aravinda Reddy [1979] 120 ITR 46*** very crisply summarises the scope of the provision of section 54 of the Income-tax Act, 1961 ('Act') and what it aims to do. Howbeit, one can only wish that the practical aspect of the law was as *simple as ABC.*

An attempt has been made in this article to analyse the provisions of section 54 and 54F of the Act. Numerous controversies have cropped up in interpreting the said provisions and one often sees either the taxpayer or the revenue authorities not accepting the other's contention and knocking the doors of the judiciary, hoping that their version of understanding the law is accepted. This article aims to only discuss the war of words over the said provisions.

The authors are thankful to The Chamber of Tax Consultants for giving them the opportunity to share their views with the readers. In the present article, as required by the scope, they have endeavoured to deal with some of major issues that have arisen or might arise in context of section 54 and 54F of the Act. However, due to paucity of space and time, they have restricted themselves to some legal precedents *qua* the respective issues involved.

Due to the vastness of the subject and the disputes arising therefrom, the authors felt it necessary to provide an index to this article, to allow the readers to study and focus on those topics which interests them.

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III. PRINCIPLE OF INTERPRETATION – BENEFICIAL PROVISIONS

Before beginning this journey, one should bear in mind that a statute is a will of the Legislature and an act of Legislature cannot foresee all types of situations and all types of consequences. Hence, the principles of interpretation of statutes come in handy, so as to bring out the intent of the Legislature. Every taxing statute comprises different kinds of provisions, having distinct and specific nature and purpose. For example, charging provisions, machinery or computational provisions, exemption provisions, penal provisions, etc. Different rules of interpretation apply for different kinds of provisions, so as to decipher its meaning, scope and extent.

It will be appreciated that though all exemption provisions provide for exception from levy of tax, but there are some exemption provisions which aim in providing certain incentives to assessees in order to achieve a larger goal for the nation. The entire purpose of such exemption provisions is not to exempt from the levy of tax, but to encourage/ provide incentive to assessees, for the betterment of the State.

Therefore, in view of the author, there are two separate species of exemption provisions. One can consider them as 'Exemption Beneficial Provisions' and 'Exemption Non-Beneficial Provisions'. Although, the ultimate goal of both is to give concession to the tax payer, nevertheless, intention for enactment is separate and distinct. Take for example, provisions of section 10(2A) and section 10AA of the Income-tax Act, 1961. The former gives an exemption from tax to the partner on receipt of distributed profits in order to avoid double taxation, as the same profits have already been taxed in the hands of the partnership firm. Here, there is no benefit or incentive given by way of an exemption. On the other hand, section 10AA encourages assessee to set up units in SEZs for the purpose of growth in exports and with a view to attract foreign and domestic investments. The intention of introducing this exemption provision is to provide incentives to the assessee with a greater aim of development of India. Thus, this section should be considered as an 'Exemption Beneficial Provision', while the former be regarded as an 'Exemption Non-Beneficial Provision'. Under the Income-tax Act, 1961, sections 10(2), 10(2A), 10(34), 10(50), are few illustrations of an 'Exemption Non-Beneficial Provisions' whereas provisions of sections 10B, 10AA, 32AD, 80G, 80-IA, 80-IB, 80-IE, etc., can be considered as 'Exemption Beneficial Provisions'.

It is a well-established rule of construction that where the object of an exemption provision is to give some incentive or benefit to an assessee, then such provisions are be construed liberally, wherein an interpretation which accomplishes the legislative intent should be adopted. A narrow construction of the exemption provisions which defeats the object cannot be preferred and it has to be given a wider construction which promotes the object. This aspect has been analysed in great detail by the Hon'ble Supreme Court on numerous occasions. See for example ***Bajaj Tempo Limited vs. CIT [1992] 196 ITR 188***; ***CIT vs. Shaan Finance (P.) Ltd [1998] 231 ITR 308***; ***CIT vs. Straw-Board Manufacturing Co. [1989] 177 ITR 431*** etc.

Having discussed generally the principles of interpretation of exemption provisions, we can now shift the focus to the subject provisions, namely, section 54 and 54F of the Act. What is the nature of these provisions? The main purpose of section 54 of the Act is to give relief in respect of profits on the sale of a residential house (see ***Sarkar vs. CIT [1981] 132 ITR 150 (Cal)*** and ***Harsutrai Raval vs. CIT [2002] 255 ITR 315 (Guj)).*** The said provisions have time and again been amended so as to boost the real estate sector. Very recently, the Finance Minister during her budget speech for Finance Bill, 2019 said so in para 93 of her speech. Hence, the purpose of granting exemption is for the betterment of the nation and therefore, these provisions can safely be considered as 'Exemption Beneficial Provisions'.

In view of the authors, the recent decision of the Hon'ble Supreme Court in the case of ***CC vs. Dilip Kumar & Company (2018) 9 SCC 1***, wherein it has been laid down that exemption provisions should be interpreted strictly and in case of ambiguity, the view that favours the revenue ought to be taken, does not have any application while interpreting exemption beneficial provisions like section 54 and 54F of the Act. The question before the Supreme Court was the rule of construction to be applied while interpreting Exemption Notification which was neither a beneficial nor does it incentivise the assessees/the nation. On the other hand, beneficial exemption provisions having their purpose as encouragement or promotion of certain activities or to encourage production or investment in new machinery or plant or a new industrial unit or setting up an industry in the backward area in terms of the industrial policy, have to be interpreted liberally. Therefore, the said principle laid down has no application to the impugned provisions of the Act.

IV. MEANING OF 'PURCHASE' AND 'CONSTRUCTION'

As per section 54/54F of the Act, assessee will be eligible for exemption if he, within a period of one year before or two years after the date of transfer purchases one residential property or within three years of transfer has constructed one residential property. As the time limit given for 'purchase' and 'construction' of a house property is different; hence, the date on which a house is considered as 'purchased' or 'constructed' is a deciding factor to be taken into consideration for allowability of deduction under section 54/54F of the Act.

The term 'purchase' or 'construction' has not been defined in the Act. Dictionary meaning of the term "purchase" is "to acquire by paying for it" and "construction" means "action of building something". In ***T. N. Arvinda Reddy (supra),*** it was held that *'there is no reason to divorce the ordinary meaning of the word "purchase" as buying for a price or equivalent of price by payment in kind or adjustment towards an old debt or for other monetary consideration from its legal meaning in section 54(1).'*

It is important to note that the terms used in the said sections are "purchased" or "constructed" in contrast to the term "owned". As a result, one may argue that the section only requires one to reinvest the consideration/net gains either towards *purchase* or *construction* of new house within specified time period, irrespective of the fact that the transaction of such a purchase or construction is complete in all aspects. Since, owning of the property is not necessary to claim the exemption as per the aforesaid sections (discussed in detail later); all conditions as per the Transfer of Property Act, 1882 or relevant law need not be complied with. Being beneficial provisions, a liberal reading is obligatory. An act of purchase or construction is sufficient to claim exemption. The Hon'ble Karnataka High Court in case of ***CIT vs. Sambandam Udaykumar (345 ITR 389)*** held that once it is demonstrated that consideration received on transfer of a capital asset is invested in a residential property, fact that transactions involved in purchase or construction of such residential property are not complete in all respects would not disentitle assessee from benefit of exemption under section 54F. Similarly, the Hon'ble Bombay High Court in case of ***CIT sv. Dr. Laxmichand Narpal Nagda (211 ITR 804)*** has held that *"It was not possible to accept the contention of the revenue that unless a regular sale deed was executed and title passed on to the purchaser, it could not be said that there was 'purchase' within the meaning of section 54. The word 'purchase' is not defined under the Act and, therefore, resort to the ordinary meaning, as understood by a layman, has to be made. In many dictionaries, the word 'purchase 'means the acquisition of property by party's own act, as distinguished from acquisition by act of law."* Further, in case of ***Anita Kanjani vs. ACIT (163 ITD 451)*** (though in a different context) has distinguished between expression 'owned' and 'purchased' and that the legislature was conscious while making use of these expressions.

Issues

A. Whether registration of deed is necessary so as to construe a transaction as 'purchase'?

As discussed above, for the purpose of the subject provisions, legal ownership of the residential house is not necessary. It is well settled that when a buyer gets title of the property from the date of issuance of allotment letter and payment of first installment is only a consequential action upon which delivery of possession flows. Even if the sale deed or agreement to sell is executed though registered subsequently, it can be said that the assessee held the property immediately from the date of allotment letter. Hence, the new house will be considered as "purchased" on the date of issuance of allotment letter. Registration of deed is not necessary to claim benefit under the aforesaid provisions. Said view has been taken recently in ***CIT vs. Vembu Vaidyanathan (413 ITR 248) [Department's SLP is dismissed (265 Taxman 535)].*** In ***Hasmukh N. Gala vs. ITO (83 taxmann.com 49),*** Hon'ble Mumbai tribunal held that even if construction is not completed and title to the property is not transferred to the assessee within specified time, but if the advance is not returned by the builder and allotment letter is issued to assessee, then date of giving advance to builder constitutes "date of purchase" of new house. The Hon'ble Delhi High Court in ***CIT vs. Kuldeep Singh (270 CTR 561)*** held that purchase is not restricted or confined to registered sale deed or even possession but has a wider connotation. The Hon'ble Andhra Pradesh High Court in ***CIT vs. Shahajada Begam (173 ITR 397***) held that *"the expression 'purchased' would undoubtedly connote the domain and control of the property given into the assessee's hands. In the instant case, apart from the payment of substantial purchase consideration, the assessee secured possession of the property on 10-8-1976, which was within the period of one year specified under section 54(1). There might have been some procedural delay in obtaining formal registration of the sale deed, but that was immaterial. In the circumstances, the assessee was eligible for exemption under section 54(1)."*

B. Whether booking of flat with builder is 'purchase' or 'construction'?

Question arises as to whether booking a flat in an under-construction project will amount to purchase or construction? Distinction between purchase and construction has been brought out by Hon'ble Mumbai Tribunal in the case of ***Farida A. Dungerpurwala vs. ITO (67 SOT 208).*** It held that the booking of a flat which is going to be constructed by a builder has to be considered as a case of "construction of flat" and it cannot be equated with purchase. Even Circular Nos. 471 dated 15-10-1986 and Circular No. 672 dated 16-12-1993 issued by CBDT have also clarified that acquisition of a flat by an allottee under the Self-Financing Scheme (SFS) of the Delhi Development Authority (DDA) amounts to 'construction' by the DDA on behalf of the allottee. Similar view has also been taken by Hon'ble Delhi High Court in ***CIT vs. Brinda Kumari (253 ITR 343)***.

C. Whether construction has to be done by assessee himself for claiming exemption?

The purpose behind the exemption under section 54(1) is that if any assessee sells his residential house and purchases a new house against that sale consideration, capital gains tax arising out of sale of the earlier house should not be taxed. Whether the assessee himself constructs the house or he gets it constructed by a contractor or third party that does not make any difference. The basic requirement for the purpose of relief under section 54(1) is that the assessee should invest the sale proceeds in the construction of residential house, which has been constructed for the assessee. Even from the plain reading of the provisions it cannot be read that house has to be constructed by assessee only. The said view is taken by Hon'ble Calcutta High Court in ***CIT vs. Bharati Kothari (244 ITR 352).***

D. What if 'construction' is not completed within the stipulated time period?

Section 54/54F provides for exemption where the assessee has constructed a house property within three years from date of transfer of the original asset. One may argue that the section does not require that the construction of the house be completed within this time period. The Hon'ble Bombay High Court in ***CIT vs. Hilla Wadia (216 ITR 376)*** has held that *what was to be seen was whether the assessee had acquired a right to a specific flat in such a building which was being constructed by the society and whether she had made a substantial investment within the prescribed period which would entitle her to obtain possession of the flat so constructed and in which she intended to reside.* Though the above judgment is in context of 'purchase', however the principles also apply to the case of 'construction'. In the above case, the Court has held that where substantial amount has been invested then exemption cannot be denied. Further, our Courts have also consistently held that exemption cannot be denied, if assessee has invested substantial amount of gains/consideration in construction of the new house, but he was prevented from completing such construction due to reasons beyond his control. This view has been taken in ***CIT vs. Girish Ragha (239 Taxman 449)***; ***PCIT v.s Dilip Ranjrekar (260 Taxman 317)***, ***CIT vs. Shakuntla Devi (389 ITR 366); CIT vs. Sambandam Udaykumar (345 ITR 389); Rajeev Shah vs. ITO (159 ITD 964)***; ***Hasmukh Gala vs. ITO (173 TTJ 507)***. Another issue which may arise in this context is where the construction is completed and an application for 'Occupation Certificate' has been made by assessee himself, however the OC has not been received or a case where the application for OC itself is made late by the assessee. In such situations as well, it can be argued that since the circumstances are beyond control of assessee exemption ought to be allowed. The Hon'ble Bombay High Court in ***Girish Ragha (supra)*** has allowed the exemption under similar circumstances.

E. What if 'construction' has already started before the sale of property?

As per section 54/54F, residential house should be constructed within three years from the transfer of original asset whereas for 'purchase' the sections expressly state that the same can be done either one year before or two years after the date of transfer of the original asset. An issue which may arise in this context is what would be the status of deduction where the construction of the house starts before the transfer of the original asset. One may argue, that since the provisions are silent as to when construction should start, the date of commencement of construction is not relevant for benefit under section 54/54F. The Hon'ble Karnataka High Court has held in ***CIT vs. J. R. Subrahmanya Bhatt (165 ITR 57)***, that the assessee was entitled to benefit under section 54F, though he had commenced construction before the transfer of the original asset but completed the construction within two years after the sale. Even the Hon'ble Allahabad High Court in ***CIT vs. H. K. Kapoor (234 ITR 753)*** and ***Mustanshir I Tehsildar vs. ITO (168 ITD 523)*** has taken with the same view.

F. What if plot has been purchased for construction of property within the stipulated period but construction has not yet started?

Both the sections 54/54F require either purchase or construction of new residential property. Thus, investment of consideration/capital gain in purchase of plot of land may not justify claim of benefit under the said sections. However, where the assessee has purchased the plot within stipulated period and his intention is to construct the property but the same has not yet started due to reasons beyond his control and he has made all efforts to construct the house, in such circumstances, exemption cannot be denied. See ***V. A. Tharabai vs. Dy. CIT (50 SOT 537); Narasimha Raju Rudra Raju vs. ACIT (143 ITD 586)***.

G. Whether modification/renovation/addition to the existing structure amounts to construction? Or Whether purchase of co-owners share amounts to purchase?

Demolition of the existing structure and construction of a new structure amount to construction for the purpose of section 54/54F of the Act. The said view is taken by Delhi High Court in ***CIT vs. Shri Ashok Kumar Ralhan 360 ITR 575 (Delhi).*** Similarly, construction of an additional floor on an existing structure also amounts to construction for the purpose of section 54/54F of the Act, however, mere modification or renovation will not amount to construction. See ***Mrs. Meera Jacob vs. ITO (313 ITR 411) (Ker.).*** On such proposition, there also exist negative precedents.

Further, release of share by the co-owner in favour of the assessee i.e., purchase of share of the co-owner amounts to purchase by the assessee for the purpose of section 54. See ***Aravinda Reddy (supra).***

H. Cost of furniture – whether to be included purchase cost?

Purchase cost of the property shall include cost incurred by the assessee on improvisation or supplementary work to make it livable. Such cost also includes cost which the assessee incurs after purchasing the readymade unit, as per his taste and requirements. See ***Shrinivas R. Desai vs. ACIT [145 ITD 12 (Ahd])***. Further, where a residential unit is purchased as a package deal, with things like air-conditioners, geysers, fans, electric fittings, furniture, modular kitchens and dishwashers, such things are integral part of the house being purchased and the cost of house has to essentially include the cost of these things as well. In such circumstances, it cannot be open to treat only the cost of civil construction as cost of house and segregate the cost of other things as not eligible for deduction under section 54. See ***Rajat B. Mehta vs. ITO 169 ITD 178 (Ahd).***

V. ONE RESIDENTIAL HOUSE

Prior to the amendment brought out by Finance Act (No. 2) of 2014, the term 'a residential house' was not defined under the Act, and as a result, controversies arose as to whether investment in more than one residential units/houses can be considered for the purpose of computing exemption under section 54/54F of the Act. The Department contends that the usage of the word "a" in the section meant only one residential unit/ house and where the investments were made in more than one residential units/houses, exemption was to be restricted only to one house/unit.

As discussed earlier, sections 54/54F are beneficial provisions and therefore various courts in different situations have taken liberal interpretation in granting exemptions. Prior to the amendment, the words were 'a residential house' and not 'one residential house'. In such context, the Hon'ble Karnataka High Court in ***CIT vs. Smt. K. G. Rukminiamma (331 ITR 211)*** was dealing with a case, where the assessee had invested in four different residential flats. In such context, it held that the expression "a residential house" is not confined to a single flat or house, because section 13(2) of the General Clauses Act, 1897 provides that singular includes the plural, unless the context otherwise requires. Also, the Court held that since all the four flats are situated in the same residential building they shall constitute "a residential house" for the purpose of section 54 and accordingly, the assessee would be entitled to deduction under section 54 in respect of all four flats. The Hon'ble High Court followed its own decision in case of ***CIT vs. Anand Basappa (309 ITR 329)*** wherein exemption was allowed even though sale consideration was invested in two residential flats adjacent to each other under two different sale deeds. Even the Hon'ble Delhi High Court in case of ***CIT vs. Gita Duggal (357 ITR 153)***, held that 'we do not think that the fact that the residential house consists of several independent units can be permitted to act as an impediment to the allowance of the deduction under Section 54/54F. It is neither *expressly nor* by necessary implication prohibited. Department's SLP in the said case was dismissed. See 228 Taxman 62. Similar view was also taken by Hon'ble Delhi High Court in ***CIT vs. Sunita Aggarwal (284 ITR 20)***; Hon'ble Andhra Pradesh High Court in ***CIT vs. Syed Ali Adil (352 ITR 418);*** Hon'ble Madras High Court in ***Abhijit Bhandari vs. CIT (396 ITR 499)***; Hon'ble Madras High Court in ***CIT vs. Gumanlal Jain (394 ITR 666)***; Hon'ble Madras High Court in ***CIT vs. V R Karpagam (373 ITR 127)***; Hon'ble Madras High Court in ***Tilokchand & Sons vs. ITO (413 ITR 189)*** and various other cases.

However, in ***ITO vs. Shushila M. Jhaveri (107 ITD 327),*** the Hon'ble Special Bench of Mumbai Tribunal, took a contrary view by holding that deduction is to be allowed only in respect of investment in one house property. However, it simultaneously also held that where the investment is in more than one house properties adjacent to each other, and they have been merged thereby have one entrance and one kitchen, then such houses shall be construed as one house property. Though this ratio of investment in one house property is not good in law in light of judgments of several High Courts, nevertheless the finding of the Court as to two houses being construed as one house property will be useful after the amendments have taken effect.

A. *Whether the replacement of the phrase 'a residential house' by 'one residential house in India' is retrospective?*

Memorandum to the Finance Bill 2014 (365 ITR (St.) 149), clearly lays down that amendment shall be effective from AY 2015-16. The Hon'ble Madras High Court in Tilokchand & Sons (supra) held it to be prospective in nature and was not merely clarificatory in nature. Also see ***V. R. Karpagam (supra).***

B. *What do you mean by 'one residential house'?*

Although 'one residential house' has not been defined but since amendment is to do away with allowing exemption in multiple residential houses, therefore, now exemption will be granted to investment made in a single residential house. Still controversies exist as to what will constitute one residential house. It can be said with certainty, that multiple residential units in different buildings cannot be construed as one residential house. But, in opinion of the authors if multiple residential units are in same building then it can be construed as one residential house if –

a. If two or more residential units are on same floor, but the same are merged into one unit having common entrance or common passage or common kitchen or

b. If two or more residential units are on different floors but converted into a single unit with common kitchen (duplex), or

c. If two or more residential units are on different floors having common kitchen

The above situations are yet to be tested in court of law in the context of the new law, though we have some precedents under the erstwhile law, wherein the Courts have held such units to be one residential house. Such cases can be relied upon even in context of the new law. Further, beneficial rule of interpretation can always be employed by the assessee.

It may be noted that the Finance Act, 2019 by amending section 54/54F has provided further relief by extending exemption to two residential houses if the capital gain earned by assessee is up to ₹ 2 crore.

VI. RESIDENTIAL HOUSE USED FOR COMMERCIAL PURPOSE – TRANSFER OF SUCH HOUSE – EXEMPTION UNDER SECTION 54 AVAILABLE?

VII. RESIDENTIAL HOUSE PURCHASED/ CONSTRUCTED BUT USED FOR COMMERCIAL PURPOSE – EXEMPTION UNDER SECTION 54/54F AVAILABLE?

The exemption of section 54 of the Act is available only if the assessee transfers a 'residential house'. Similarly, it is necessary for an assessee to purchase/construct a 'residential house' within the prescribed time. However, the Act does not define as to what constitutes a 'residential house'. The scope of this term becomes relevant, since in certain scenarios, there are disputes between the assessees and the revenue authorities as to whether a capital asset transferred constitutes a 'residential house'. One such scenario is discussed in the ensuing paras.

It is not uncommon for an assessee to use residential house owned by him to be used for commercial purposes. Say for example, a doctor owns a clinic, which is situated in a residential housing society and he is operating his medical practice from such clinic. In such a case, if the doctor transfers his clinic for a consideration, generating capital gains in the process, and immediately, acquires another property, which was used by him as his clinic, out of the consideration he had received on transfer of his old clinic, a question can arise if the doctor can claim exemption under section 54 of the Act. The old clinic though in a residential premise, was used by the doctor for his commercial purpose and he was not residing in such a house. Can this old clinic be considered as 'residential house' for the purpose of section 54 of the Act?

The real test to judge the nature of the house is to see if the property is put to residential use, while a residential property designed for residence and located in a residential locality will ordinarily qualify for treatment as residential house, so that even if it is put to office use, there should be no difficulty in accepting the same as a residential property. Thus, where the house property constructed is a residential house, that it has a kitchen, bathrooms, bedrooms, etc., its use for non-residential purpose, does not make the house property non-residential. Accordingly, the benefit under section 54 cannot be denied on the ground that the house, since used for commercial purposes, cannot be considered as *residential house* for the purpose of section 54. The Act does not require that the house should be used in a particular manner. It only requires that the house should be a *residential house.* In ***N. Revathi vs. ITO [2015] 153 ITD 285 (Hyd)***, the Tribunal held that only *"because building was used as school could not change nature and character of building from residential to commercial. Even residential building could be used as school or for any other commercial purpose. But relevant factor to judge was whether construction made was for residential house or for commercial purpose. If building had been constructed for residential use with all amenities like kitchen, bath room etc., which were necessary for residential accommodation then even if it was used as school or for any other commercial purpose, it could not lose its character as residential building. However, if construction was made in such way that it was not normally for residential use but purely commercial use, then it could not be considered to be residential house. If building had been constructed for residential use with all amenities, which were necessary for residential accommodation, then exemption under section 54F could not be refused only because it was being used as school subsequently."*

The above reasoning will equally apply in a scenario where the assessee acquires a residential house, but is subsequently used for non-residential purposes. Therefore, such usage will not disentitle an assessee from claiming the benefit of section 54/54F of the Act.

The Delhi Tribunal in ***Mahavir Prasad Gupta vs. JCIT [2006] 5 SOT 353*** held that the mere non-residential use would not render a property ineligible for benefit under section 54F, if it is otherwise a *residential house.* In that case, the revenue authorities denied benefit under section 54F to the assessee on the ground that the new asset constructed was not a residential house, since it was not used for residential purposes. Also see ***Amit Gupta vs. DCIT [2006] 6 SOT 403 (Del)***; ***Anoop Kumar Gupta vs. ACIT (53 CCH 40)***; ***Shyamlal Tandon vs. ITO (62 SOT 105)(Hyd)***; ***ITO vs. Sandhya Saxena [2006] 7 SOT 527 (Mum)***; ***M. V. Subramanyeswara Reddy (HUF) (ITA No. 1014/Hyd-09***).

In ***Sanjeev Puri [2016] 180 TTJ 649 (Del)***, it was held that where a property had been shown as residential house in municipal record but it had been actually used by assessee as his professional office, said property could not be treated as residential house on basis of municipal records, ignoring actual usage by the assessee. This, in view of the author, is not the correct test to determine the scope of 'residential house'. None of the aforesaid principles have been considered by the Tribunal and therefore, not a good precedent.

However, if such a residential house is used for commercial purposes, then for the purpose of section 54F, such a house will be considered for the purpose of 'residential house already owned' as on the date of transfer and accordingly, the benefit will not be available to such an assessee.

VIII. JOINT OWNERSHIP – WHETHER ELIGIBLE FOR EXEMPTION

A. New Residential House – Jointly Owned

A controversy that often takes place between the taxpayers and the department is whether benefit of section 54/54F of the Act is available when the new residential house purchased is jointly owned by the assessee with some other person, say spouse, children, etc. The Revenue authorities largely contend that the exemption under the said provisions is available only if the transferor assessee himself purchases the new asset. However, in case where the new house is jointly owned, since the new house is not only owned by the transferor assessee, the benefit under section 54/54F is not available. Alternately, they contend the exemption should be restricted to the share of the transferor assessee in the jointly owned new property.

The rationale of the above stand is that the object of the said provisions is to give benefits to the assessee on conditions as are elaborated in the sections. No benefit is available to a person other than the assessee. It means that the assessee must comply with the conditions strictly as per this provision in all respects. The purpose is to give this benefit on the ownership of one residential house only by the assessee and to encourage to have one residential house by the assessee. Therefore, right from the sale of original asset till the purchase and/or construction of the residential house, i.e., the 'new asset', the ownership and domain over the new asset is a must. The new property must be owned by the assessee and/or he must be having legal title over the same. The others may use and occupy the same along with the assessee, but the ownership of the residential house so purchased should be that of the assessee from the net consideration/sale proceeds of the sale of original asset. This view is taken by the Hon'ble Bombay High Court in the case of ***Prakash vs. ITO [2009] 312 ITR 40,*** the Hon'ble Punjab & Haryana High Court in ***Jainarayan vs. ITO [2008] 306 ITR 335*** & ***Kamal Kant Kamboj vs. ITO [2017] 397 ITR 240*** and the Chennai Bench of the Income Tax Appellate Tribunal in ***D. Devadass vs. ITO [2016] 48 ITR(T) 613***.

On the other hand, the assessees maintain that section 54/54F mandates that the new house should be purchased by the assessee and it does not stipulate that the house should be purchased in the name of the assessee only. Where the entire purchase consideration was paid only by the transferor assessee and not a single penny was contributed by any other person, a purposive construction should be preferred as against a literal construction, more so when even applying the literal construction, there is nothing in section 54/54F to show that the house should be purchased in the name of the assessee only. Section 54/54F in terms does not require that the new residential property shall be purchased in the name of the assessee and it merely says that the assessee should have purchased/constructed 'one residential house'. Several High Courts and benches of the Tribunal have taken the above view. See for example ***DIT vs. Mrs. Jennifer Bhide [2012] 349 ITR 80 (Kar.)***; ***CIT vs. V. Natarajan [2006] 287 ITR 271 (Mad.)***; ***CIT vs. Gurnam Singh [2010] 327 ITR 278 (P&H); CIT vs. Kamal Wahal [2013] 351 ITR 4 (Delhi); CIT vs. Ravinder Kumar Arora [2012] 342 ITR 38 (Delhi); Dr. Smt. P.K. Vasanthi Rangarajan vs. CIT [2012] 209 Taxman 628 (Mad.); Laxmi Narayan vs. CIT [2018] 402 ITR 117 (Raj); Bhatkal Ramarao Prakash vs. ITO [2019] 175 ITD 144 (Bang.); N. Ram Kumar vs. ACIT [2012] 138 ITD 317 (Hyd) and others.***

In view of the author, the taxpayers' contention in this dispute deserves to be accepted. As seen earlier in this article, the impugned sections are substantive provisions, enacted with the purpose of promoting purchase/construction of residential houses. Therefore, an interpretation which promotes such objective of the beneficial provisions should be adopted. These sections ought to be construed liberally. The only requirement of the provision is that the consideration/net gains must be invested in a new residential house by the assessee. Nowhere do the provisions mandate that the new residential house should be registered only in the name of the assessee. Adopting such an interpretation would result in imposing a condition, which the law does not provide so. This cannot be permitted. As seen above, large number of decisions have allowed the exemption where the new asset is jointly owned by the transferor assessees.

Apart from the above, the decisions in *Prakash (Bom); Jai Narayan (P&H), Kamal Kant Kamboj (P&H) and Devadass (Chn)* cannot apply to cases where the new asset is jointly owned by the assessee and some other person. The principle laid down in those cases pertain to a scenario where the new house is only in the name of some other person and not the transferor assessee, who is claiming the benefit the exemption. For example, in *Prakash*, the assessee purchased the new house solely in the name of his adopted son. This was not a case of joint ownership. Therefore, for the present dispute, the above mentioned cases have no application. Yet, the Madras High Court in ***V. Natarajan (supra)*** allowed the benefit even in the case where the new property was purchased in the name of the wife of the assessee. In Laxmi Narayan, the Rajasthan High Court took a liberal view and held that where an assessee had purchased a new agricultural land out of sale consideration of his agricultural land, he could not be denied deduction under section 54B merely because registered document of new land was executed in name of his wife. The Tribunal in many cases has resolved the conflict between Bombay, Punjab & Haryana High Courts and Madras & Rajasthan High Court by applying the principle laid down by the Hon'ble Supreme Court in ***CIT vs. Vegetable Products Ltd. [1973] 88 ITR 192*** and taking a view which favours the assessee. Thus, even if the new residential house is in the name of some other person, the exemption is to be given to such assessees. In the opinion of the author, the material factor here would be that the assessee should have domain and control over the new asset. This test has been fortified by the Hon'ble Bombay High Court in ***CIT vs. Mrs. Hilla J.B. Wadia [1995] 216 ITR 376.*** The fact that it is in the name of another person is irrelevant till the assessee holds control over the asset.

B. Old Residential House – Jointly Owned

In order to claim benefit of section 54F of the Act, a key condition to be complied with is that the assessee should not own more than one residential house, other than the new asset, on the date of transfer of the original asset (See 1st Proviso to sub-section (1) of section 54F). Difficulty arises when an assessee is a co-owner of two or more residential houses at the time of transfer of the old asset and thus, whether the proviso is said to have been triggered so as to disentitle the assessee from claiming the benefit of section 54F.

In ***Ashok G. Chauhan vs. ACIT [2019] 176 ITD 717 (Mum)*** recently dealt with this issue in detail. After considering various precedents on the subject, the Tribunal granted the benefit of section 54F to the assessee, who along with his wife, was a joint owner of the house, on the ground that word 'own' in section 54F would include only cases where a residential house is fully and wholly owned by assessee and, consequently, would not include a residential house owned by more than one person. Ownership of a residential house, in our opinion, means ownership to the exclusion of all others. Therefore, where a house is jointly owned by two or more persons, none of them can be said to be the owner of that house. Tribunal relied on the judgment of the Hon'ble Supreme Court in the case of ***Seth Banarsi Dass Gupta vs. CIT [1987] 166 ITR 783,*** wherein it was held that a fractional ownership was not sufficient for claiming even fraction depreciation, pre-amended section 32. Thus, an assessee cannot be treated as 'absolute owner' of a residential house if it is jointly owned by more than one person and therefore, the exemption under section 54F of the Act cannot be denied to the assessee. Also see ***Rasiklal N. Satra [2006] 98 ITD 335 (Mum.)*** and ***V. R. Usha vs. ITO [2016] 159 ITD 402 (Chn.)***.

C. *Old Residential House – Jointly Owned – Tax Planning vs. Tax Avoidance*

As seen above, for the purpose of section 54F of the Act, only a case of 'absolute ownership' of the residential property can be considered as 'owned' as referred to in the 1st proviso. Certain taxpayers are tempted to take benefit of this. Where an assessee owns more than one residential house, they may covert the sole ownership of the extra house into a joint ownership by transferring the house in the name of some other person, say spouse, child or close relative, etc., so as to supersede the provisions of the Act and claim exemption under section 54F. Does this amount to tax planning or can the department deny the benefit to such assessees on the ground that taxpayer has adopted a device only to avoid tax?

The subject of *'Tax Planning vs. Tax Avoidance'* is not alien to the income tax law and several long-drawn battles between the assessees and the revenue authorities have been witnessed in the past. This topic has always been very subjective and a lot depends on the facts and circumstances of each case. Earlier, no formal provisions were present in the Act dealing with tax avoidance (not that such an absence stopped the revenue authorities from questioning the assessees). However, with Finance Act, 2012 having enacted the provisions of Chapter X-A, dealing with GAAR, into the statute, the department now has legs to stand by examining and probing into dubious and feeble transactions.

The non-obstante provision of section 95 states that an arrangement entered into by an assessee may be declared to be an 'impermissible avoidance arrangement' and the consequence in relation to tax arising therefrom may be determined. An 'impermissible avoidance arrangement' is one that has as its main purpose the obtaining of a tax benefit. It must also satisfy the circumstances stipulated in clauses (a) to (d) of section 96 of the Act. Where a transaction has been carried out for sound commercial purposes, in view of the author, the same cannot be said to be entered into with the 'main purpose' of obtaining a tax benefit. An assessee who converts his house property from sole ownership to joint ownership may have to justify *bona fides* of his actions, if the same takes place just before the transfer of the original asset. The revenue authorities are likely to question the substance and the commercial rationale of such conversion. If they do hold that the assessee in such case has resorted to a device, then in such a case, the benefits of section 54F may be denied to the assessee.

It is however well-settled that there is no requirement or provision in the Act that mandates an assessee to adopt a course of action or transaction that would maximise the assessee's tax outflows. On the contrary, the Central Board of Direct Taxes has clarified that the provisions of GAAR will not *"interplay with the right of the taxpayer to select or choose method of implementing a transaction"* (See Question No. 3 of Circular No. 7 of 2017 dated 27-1-2017). It is well-established that an assessee is free to arrange his affairs in any manner which reduces his tax liability, provided he is within the four corners of law. An act, which is otherwise valid in law, cannot be treated as *non-est* merely on the basis of some underlying motive supposedly to reduce tax revenues. The above principles have been echoed on numerous occasions by our courts including the Hon'ble Supreme Court. (See ***UOI vs. Azadi Bachao Andolan [2003] 263 ITR 706; CIT vs. Walfort Share & Stock Brokers (P.) Ltd. [2010] 326 ITR 1*** and ***Vodafone International Holdings B.V. vs. UOI [2012] 341 ITR 1).***

IX. DEATH OF ASSESSEE BEFORE EXPIRY OF TWO/THREE YEARS – WHETHER LEGAL REPRESENTATIVE ELIGIBLE FOR EXEMPTION IF HE PURCHASES/ CONSTRUCTS NEW RESIDENTIAL HOUSE

It may so happen that before the expiry of two/three years from the date of transfer, the individual assessee deceases, without making any investment in new house. However, the legal representative of such assessee makes the investments within the prescribed time. The question arises as to whether the benefit of section 54/54F of the Act is available to such legal representative since the assessee who sold the house was a different person from one who purchased the house.

The answer to this question rests in the provisions of section 159 of the Act. The said provisions deal with 'Legal Representative' wherein it provides who can be subject to tax as 'legal representative' and also states how such a legal representative will be taxed on behalf of the assessee deceased. Sub-section (1) of the said section states that the legal representative will be subject to tax in the like manner and to the same extent as the deceased assessee. Further, sub-section (3) states that the legal representative of the deceased shall, for the purposes of this Act, be deemed to be an assessee. In other words, once an assessee expires, by virtue of section 159 of the Act, the legal representative replaces such an assessee in the eyes of law and for all practical purposes, the legal representative is the assessee. Therefore, not only is the legal representative liable to pay taxes on behalf of the deceased, he is also entitled to all benefits, exemptions or deductions which the deceased was otherwise entitled to. The legal representative is deemed to be the assessee for the purpose of the Act. Hence, it is incorrect to state that legal representative, who purchases/constructs the new residential house, is a different person from the assessee who sold the house.

One may also refer to the decision of the Hon'ble Madras High Court in ***C.V. Ramanathan vs. CIT [1980] 125 ITR 191*** and Hon'ble Andhra Pradesh High Court in ***Mir Gulam Ali Khan vs. CIT [1987] 165 ITR 228***, wherein the High Court rejected the argument to read the provisions of section 54/54F strictly, instead preferred a liberal reading of the section. The benefit was granted to the legal representative assessees *de hors* referring to the provisions of section 159 of the Act.

X. IS IT NECESSARY TO REINVEST THE CONSIDERATION RECEIVED ON SALE OF THE ASSET TRANSFERRED?

It is worthwhile to note that though section provides exemption on investment of the amount of gains (section 54) or net consideration (54F) in a new residential house, the section nowhere requires investment of the very same sale consideration which one has received on the transfer of the original assets. The only condition which the sections i.e., sections 54(1) and 54F(1) prescribe is investment in the new house either by way of purchase or construction. Further, even the provisions of sub-section (2) of section 54 and sub-section (4) of section 54F requiring deposit of amount in capital gains account scheme does not envisage the depositing of the same sale consideration. The section only requires 'the amount' of capital gains or net consideration to be deposited. Here the word amount does not refer to the very same consideration but rather denotes the quantum of the sum to be deposited.

The sections allow benefit even in a case where purchase has been made one year prior to the transfer of the original asset, which also adds strength to the argument that there is no such requirement of utilising the same sale consideration, as in such case, one cannot invest the consideration even before receiving the same. Further, the time limit to invest in the new house is counted from the date of transfer of the asset and not from date of receipt of the consideration. This again can be used to argue that the same sale consideration need not be utilised to invest. Accordingly, a person can utilise funds from other sources, any loans including housing loan etc. to invest in the new house to claim benefit under section 54/54F of the Act. One can utilise the sale consideration for any purpose and need not block it for reinvestment purposes. See ***CIT vs. Pasricha (ITXA No. 1825 of 2009)(Bom);***

ITO vs. Gopalan (162 CTR 566)(Ker); CIT vs. Kapil Kumar Agarwal (382 ITR 56)(P&H); Gouli Mahadevappa (356 ITR 90)(Kar) and others. Though, there are also certain precedents which have taken a negative view in respect of this issue. One can always argue that beneficial view should be taken if there exists more than one view.

XI. SALE OF TWO ASSETS AND PURCHASE OF ONE HOUSE

A. Sale of two houses and purchase of one house

We have discussed the tax treatment of sale of one house and purchase of two houses. Take a reverse case, wherein a person transfers two house properties in the same year and invests in one bigger house, whereby the capital gains arising on both the houses are invested in the new house. In such a case, exemption under section 54 can be claimed in respect of capital gains arising on both the house properties on investment in the new house. There is no requirement in law that a new residential house has to be purchased for a house sold. If at all any support is required then reliance can be placed on the judgment of ***DCIT vs. Ranjit Vithaldas (137 ITD 267)(Mum).***

Suppose, a person transfers a house property in year one and earns capital gains of ₹ 1 crore and invests ₹ 1.5 crore in another property before the due date of filing of return of income. Thus, an exemption of entire capital gains can be claimed under section 54. In the next year the same person transfers another house property after such due date of filing of return for the first year and earns capital gain of ₹ 60 lakhs. Such transfer is within 1 year of the purchase of the new house property. In such a case, while computing capital gains for the transfer of house property in the second year, exemption under section 54 can be claimed of the balance investment in the new house property which will be ₹ 50 lakhs.

Though in the above case, one can argue that even in the second year entire capital gain of ₹ 60 lakhs should be allowed as a deduction. This is on the basis that what the section require is investment in the new house property within the prescribed time limits and if the same is done, then capital is to be dealt with in accordance with the provisions of the section. Thus, there is no requirement to invest the very same capital gains and also there is no upper cap that the maximum deduction that can be claimed will be to the extent of investment of the new house property. The above argument though satisfies the condition of section 54(1), however, the same may not be able to survive the application of section 54(2), which requires the amount of capital gains to be either appropriated or to be utilised. In this regard, one can refer to the judgment of the Mumbai Tribunal in ***Anagha Ajit Patnekar (9 SOT 685),*** wherein the Tribunal held that for claiming exemption qua the second asset, the unexhausted cost of the new asset can be taken.

B. Sale of two assets other than residential house and purchase of one house

The above discussion will also apply *mutatis mutandis* where there is sale of two long term capital assets other than the residential house and investment in one residential house i.e., in context of section 54F. When a person transfers two long term capital assets one being shares and other being land, and if he invests the net consideration of both shares and land in purchase of new house, then he shall get complete exemption in respect of the capital gains of both the assets. However, if the amount invested in the new house is less than the total net consideration received on transfer of both the assets, then proportionate deduction shall be allowed. In such case, different permutations and combinations have to be considered while computing the amount of deduction, i.e., first entire net consideration of one asset is to be apportioned towards the new asset and then the balance cost of the new asset is to be apportioned towards the second asset and so on, in such a manner so as to get maximum deduction. Generally, the asset whose ratio of gains to net consideration is higher should be preferred for the purpose of the allocation.

C. Sale of one residential house and one asset other than residential house and purchase of one house

Take a case where a person transfers two capital assets one being a residential house and other being share being a long term capital asset and he purchases a new residential house. In such a case, the person will be eligible to claim deduction both under section 54 and 54F of the Act. In such case, if the person invests the capital gains on sale of the residential house and the net consideration on sale of shares, then he shall be able to claim deduction of the entire capital gains. However, if the amount invested is less that the above mentioned sum, then priority should be given to deduction under section 54 and then under section 54F as under the earlier section 100% of the amount invested is available as deduction whereas under the latter section only proportion of the capital gains to the net consideration is allowed as deduction.

There may also arise a case, where a person transfers a house property in 1st year and invests in the house property in the same year; such investment being in excess of the capital gains. Thus, exemption will be claimed for the entire capital gains amount. If in the second year, the person transfers say long term capital assets being shares, such transfer being within 1 year from the date of the acquisition of the new house property, then qua the unexhausted cost of acquisition, deduction can be claimed from the capital gains arising from the sale of shares. Further, such new house property cannot be considered while calculating the number of houses owner by such person under sub-clause (i) of clause (a) of the proviso to section 54F(1).

XII. IMPACT OF SECTION 50C

Section 50C is an anti-abuse provision introduced to tackle the menace of black money in transactions involving immovable properties. It basically, deems the stamp duty value to be full value of consideration on transfer of an immovable property if the actual consideration is less than the Stamp Duty Value (SDV). Thus, the amount of capital gains increases as a result of applicability of section 50C. Such section also has some consequences for exemption under section 54 and 54F of the Act. The same is discussed hereunder:

Section 54

Section 54 requires the capital gains to be invested for claiming exemption. Such capital gains, if computed after applying section 50C in cases where the actual consideration is less that the SDV, would be a much bigger figure than the one computed without applying section 50C. However, such difference between the SDV and the actual consideration is not received by the assessee. Therefore, the controversies will be as under:

a. Whether one has to apply section 50C to cases of section 54 *per se*? or

b. Whether if the capital gains computed on actual consideration is invested, then no capital should be charged to tax even after applying 50C? or

c. Whether a person has to invest capital gains computed after applying section 50C?

The answer to the above issues lies in the simple principle "equity and tax are strangers". Section 50C states that for the purpose of section 48, the SDV would be treated as full value of consideration. Thus, capital gains have to be computed using the SDV. Thereafter, section 54 states that one has to invest the capital gains in purchase or construction of a residential house property. Such capital gains have to be definitely the capital gains computer under other provisions of the Act which is after applying section 48 and 50C. There is no other way to compute capital gains. Accordingly, one has to invest the capital gains amount which is computed after applying section 50C.

One can argue that section 50C is a deeming fiction and that its application has been limited to section 48 and that the same cannot be stretched for the purpose of section 54 of the Act. However, even in such a scenario, nothing is possibly gained. Section 54 does not prescribe any other method to compute capital gains. The other argument of hardship, is generally not accepted by the Courts, especially in a case, where a section is introduced for anti-abuse measures. Recently, the Hon'ble Bombay High Court in case of ***Jagdish C. Dhabalia vs. ITO (308 CTR 295)***, has held that for the purpose of section 54EC, capital gains as computed by applying section 50C has to be taken into account. The said judgment squarely applies to section 54 also, though it may not apply to section 54F, which is discussed in the ensuing para. This judgment, in our understanding is the only High Court judgment on this issue.

Section 54F

The position will be substantially different in context of section 54F. In contrast to section 54 where an assessee is required to invest capital gains, under section 54F, an assessee is required to invest the net consideration. *Explanation* to section 54F(1) defines net consideration as "net consideration, in relation to the transfer of a capital asset, means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer". Further, section 50C deems SDV as full value of consideration only for the purpose of section 48 and therefore, its reach shall not be extended to section 54F. Thus, for the purpose of section 54F(1), net consideration has to be the actual consideration and not a notional figure.

Deduction from capital gains under section 54F(1) is available in proportion of the amount invested and the net consideration. Thus, if the entire net consideration is invested, then the entire capital gains becomes exempt. Further, capital gains have to be computed as per section 45 r.w.s. 48 and 50C. Thus, the capital gains would be computed after applying section 50C and if the entire net consideration i.e. the actual consideration and not the deemed one under section 50C, is invested then, the entire gains becomes exempt. This view is taken by number of tribunal benches. See ***133 TTJ 482(Jp) Gyan Chand Batra vs. ITO; 161 ITD 721 (Vis) DCIT vs. Chalasani Mallkarjuna Rao; 172 ITD 0525 (Lk) Anant Chetan Agarwal 69 ITR (T) 231 (Kol); Sabita Devi Agarwal vs. ITO.*** One more logic to support the above argument is that a person cannot invest more than what he has received as it would amount to doing an impossible task.

The judgment of the Hon'ble Bombay High Court in ***Dhabalia (supra)*** should not apply in context of section 54F as the High Court was not dealing with the term 'net consideration' which is specific to section 54F.

In any case, where the person invests more than the actual consideration i.e. the deemed consideration as per section 50C, by either using funds from difference source or by way of loan, then there should arise no controversy in getting full deduction under section 54F. Investment from any other source should be an issue as already discussed elsewhere.

XIII. NON-DEPOSIT OF CONSIDERATION INTO 'CAPITAL GAINS ACCOUNT SCHEME' *PER SE* IS FATAL?

The Finance Act, 1987 inserted sub-sections in sections 54, 54B, 54D, 54F and 54G of the Act, all of which respectively provided that the capital gain or net consideration, as the case may be, if not utilized in purchase or construction of the new asset, before furnishing the return of income, is deposited in the Capital Gains Account Scheme in a bank, before the due date for furnishing the return of income under section 139 of the Act, then for the purpose of sub-section (1) of the respective sections, such amount deposited by an assessee was to be deemed to be the cost of the new asset. In other words, the amount of unutilized capital gains or net consideration, as the case may be, would be eligible for exemptions under sections 54, 54B, 54D, 54F and 54G of the Act, if such unutilized amounts were to be deposited in a Capital Gains Account Scheme before the due date for furnishing the return of income under section 139 of the Act.

For the present discussion, let us take the provisions of sub-section (2) of section 54 of the Act as the exemplar, since the language of the sub-sections of the other sections are *pari materia*. A study of this sub-section will equally apply to the other provisions as well.

A question that is often raised is the whether the non-deposit of capital gains into the specified 'Capital Gains Account Scheme' within the prescribed time limit can lead to denial of exemption under section 54 of the Act. Judicial views of this simple, yet vital question, are divided. These conflicting views can be sourced to the principles of interpretation of the provision of sub-sections (2) of sections 54 and sub-section (4) of 54F of the Act.

One school of thought reads the provisions liberally and considers the entire scheme of the exemption provisions and its purpose to hold that if an assessee invests the entire consideration in construction of the residential house within three years from the date of transfer, he cannot be denied deduction under section 54 of the Act on the ground that he did not deposit the said amount in capital Gain Account Scheme before the due date prescribed under section 139 of the Act. Courts have held that a strict reading of the provisions of section 54(2) of the Act will defeat the entire exemption provision, which cannot be the purpose of the enactment. This on the logic that as per the provisions of sub-section (1) of section 54 of the Act, if an assessee, after sale of his residential property, has within a period of one year before or two years after the date of such transfer or within a period of three years, constructs a residential house, the capital gains will not be charged to tax up to the extent of the amount spent on the purchase or construction of residential house. Sub-section (1) of section 54 of the Act is a substantive provision enacted with the purpose of promoting purchase/construction of residential houses. However, subsection (2) of section 54 is an enabling provision which provides that the assessee should deposit the amount earned from capital gains in a scheme framed in this respect by the Central Government till the amount is invested for the purchase/ construction of the residential house. This provision has been interpreted as an enactment to gather the real intention of the assessee to invest the amount in purchase/construction of a residential house. As per the provisions of sub-section (1) of section 54, the assessee has been given two years' time to purchase and three years' time to construct a residential house subsequent to the date of transfer of the original asset. Prior to insertion of sub-section (2), practical difficulties were faced wherein, at the time of the assessment proceedings, subsequent to the date of transfer of the original asset, an assessee would claim that he will invest the amount in purchase/construction of a new house, though not have taken any steps towards that direction till then. In such a scenario, there was no basis or any method or procedure before the Assessing officer through which he could gather the real intention of the assessee, as the assessee, by saying so, could delay the taxation of the capital gains earned at least for three years from the date of transfer of original asset. Hence, sub-section (2) has been considered to have put an embargo on the assessee to casually claim the benefit of section 54 at the time of assessment, without being any act done to show his real intention of purchasing/constructing a new residential unit. It is an enabling provision which governs the Act of the assessee, who intends to claim the benefit of the exemption provisions of section 54. The real purpose of the enabling provision is the compliance of the substantial provision of sub-section (1) to section 54 of the Act. Sub-section (2), in fact, regulates the procedure for the substantive rights of the exemption provisions under section 54 of the Act. This section does abridge or modify the substantive rights given vide sub-section (1) of section 54 of the Act, otherwise, the real purpose of substantive provision i.e., sub-section (1) will get defeated. The primary goal of exemption provisions of section 54 is to promote housing. The procedural and enabling provisions of sub-section (2) cannot be strictly construed to impose strict limitations on the assessee and in default thereof to deny him the benefit of exemption provisions. Accordingly, if an assessee at the time of assessment proceedings, proves that he has already invested the capital gains on the purchase/construction of the new residential house within the stipulated period, the benefit under the substantive provisions of section 54(1) should not be denied to the assessee. Any different or otherwise strict construction of sub-section (2) will defeat the very purpose and object of the exemption provisions of section 54 of the Act. The above liberal interpretation of the provisions has been espoused in ***K. Ramachandra Rao [2015] 230 Taxman 334 (Kar); Sunayana Devi [2017] 167 ITD 135 (Kol); Seema Sabharwal [2018] 169 ITD 319 (Chd)*** and ***M.K. Vithya [2018] 91 taxmann.com 102 (Che).*** The Hon'ble Supreme Court in the case of ***Sanjeev Lal vs. CIT (Civil Appeal Nos. 5899-5900 of 2014) dated 1st July 2014*** agreed to give harmonious reading to the provisions of section 54 of the Act which subserve the object and purpose of the provision should be made. The Hon'ble Court expressly refused to read the exemption provisions strictly.

The other school of thought reads the provisions of section 54 strictly and holds that no occasion to give a beneficial construction to a statute can arise when there is no ambiguity in the provision of law which is subject to interpretation. Applying this principle, courts have held that if an assessee fails to comply with the provisions of sub-section (2), where he files the return of income and the entire amount which is subjected to capital gain tax is not utilized for purpose of purchase/construction of new house, nor is the unutilised amounts deposited in notified Bank Accounts before filing return of income, then the exemption under section 54 is not available to such an assessee. this is because the assessee failed to comply with the mandate provided in the sub-section. Any other reading of the provisions, will make the said sub-section completely otiose. This has been held to be not permissible. In fact, the provisions of sub-section (1), i.e. the substantive provisions are subject to the fulfilment of the provisions of sub-section (2) of section 54 of the Act. Sub-section (2) speaks of two conditions for availing deduction under section 54(1). Firstly, the assessee has to utilize the capital gains in purchase of new property before the date of furnishing of return of income under section 139. Secondly, if it was not done so, it has to be deposited in a Capital Gain Account Scheme before the due date of furnishing of return of income as provided under section 139. Hence, in the face of the clear words of the statute and the absence of any ambiguity, the intent of parties and/or beneficial construction is held to be irrelevant. These views have been adopted in ***Humayun Suleman Merchant [2016] 387 ITR 421 (Bom); Basaribanu Latiwala vs. ITO [2018] 193 TTJ 191 (Mum)*** and several others. In fact, the Hon'ble Bombay High Court has distinguished the decision of the Hon'ble Karnataka High Court on the ground that the said decision was *sub-silentio* having been rendered without any analysis of sub-section (2) of the section 54 of the Act.

It is the manner of reading the provisions of section 54 of the Act which has led to the contrary views. In absence of any ambiguity, does one interpret the provision strictly and follow what is stated or does the section deserve a liberal reading.

The authors are of the opinion that the former school of thought, viz., a liberal interpretation of the provision is the correct way to read the sub-section. One must not forget that section 54 is a beneficial provision, where the object of the exemption provision is to give some incentive or benefit to an assessee. The primary goal of exemption provisions of section 54 is to promote housing. The provisions of section 54 of the Act is, beyond any doubt, a beneficial provision and has been read liberally by courts on numerous occasions. For example, if the new residential house is purchased by an assessee jointly in the name of the spouse, then too, courts have granted exemption under the said section on the ground that a liberal reading is required to encourage the object of the provision (this aspect is covered in detail later in this article). Accordingly, the same provision cannot be subjected to different rule of construction. A uniform principle of interpretation ought to be adopted.

It must also relevant to note that the provision of sub-section (2) is a deeming provision and is inserted in the statute for a specific purpose. The objective of insertion of the sub-section is apparent from the Explanatory Memorandum of Finance Bill, 1987 [(1987) 165 ITR (St.) 162] – *"With a view to dispensing with such rectification of assessment, the Bill seeks to provide for new scheme for deposit of amounts meant for rein-vestment in the new asset."*

Prior to insertion of sub-section (2), the revenue authorities were frequently required to rectify the assessment orders so as to bring to tax the capital gains original arisen on transfer of the old asset. Such gains were not taxed since the assessee had promised to utilize/appropriate the amount towards a new residential house. Having failed to do so, the original assessment order required correction. With a view to *"dispense with such rectification of assessment"*, the said Finance Act inserted the provision of sub-section (2). Therefore, only for this limited purpose and to regularise the manner in which the assessees claim the exemption under section 54(1) of the Act, the provisions of sub-section (2) have been enacted. Hence, giving a strict reading to the sub-section, will defeat the purpose of the beneficial provision, which, according to the authors, is not correct, keeping in view the rule of construction endorsed in ***Bajaj Tempo (supra)*** and others.

On the flip side, certain practical difficulties may crop up if the sub-section (2) is not read strictly. As per section 153 of the Act, an order of assessment under section 143 needs to be passed by the assessing officer within twenty one months from the end of the assessment year. However, the upper limit for claiming exemption under section 54 is three years from the date of transfer, which could expire even after the due date of passing the order for that assessment year. In such a scenario, it will be difficult for the assessee as well as the revenue authorities to give effect to the exemption under section 54 if the assessee invests in the residential house after such due date but before the expire of three years.

It is only a matter of time that the Hon'ble Supreme Court, higher courts interpret the subject provisions and clarity on the subject is desirable on the above issue, so as to avoid further litigation.

XIV. WHETHER UTILIZATION UP TO THE DATE OF FILING RETURN OF INCOME WILL MEAN ONLY UP TO THE DUE DATE OF FILING RETURN UNDER SECTION 139(1)?

Another dispute that often crops up between the revenue authorities and the tax payers is as to whether an assessee can claim exemption under section 54 of the Act where such an assessee has deposited the unutilised capital gains after the due date of filing of return under section 139(1) but before time prescribed under sections 139(4)/139(5) of the Act?

Courts have in most cases held the issue in favour of the taxpayers. They have, on a plain and literal interpretation of the provisions of sub-section (2) of section 54, concluded that the conscious, purposive and intentional use by the legislature of the words "date of furnishing the return of income under section 139" cannot be substituted and narrowed down to section 139(1) of the Act. The date of furnishing of the return of income under section 139 would encompass within its sweep, the time limit provided for filing of the 'return of income' by an assessee under section 139(4) as well as the revised return filed by him under section 139(5) of the Act. On the basis of an argument that due date under section 139(1) is extended by the time limit under section 139(4)/139(5), in the under mentioned cases, it has been held that even if the deposit in capital gain deposit account is made within time prescribed under section 139(4)/139(5) is filed, the deduction under section 54 will be available. See ***CIT vs. Jagriti Aggarwal [2011] 339 ITR 610 (P&H); CIT vs. Rajesh Kumar Jalan [2006] 286 ITR 274 (Gau); Fatima Bai vs. ITO [2009] 32 DTR 243 (Kar); Rajan Gumba Telang vs. PCIT [2019] 112 taxmann.com 94 (Mum); ITO vs. Nilima Abhijit Tannu [2019] 177 ITD 308; Kamal Murlidhar Mokashi vs. ITO [2019] 179 ITD 265 (Pun); Nipun Mehrotra vs. ACIT [2008] 110 ITD 520 (Bang); J. V. Krishna Rao v. DCIT [2012] 54 SOT 44 (Hyd); Kishore H. Galaiya vs. ITO [2012] 137 ITD 229 (Mum.); PCIT vs. Shankar Lal Saini [2018] 253 Taxman 308 (Raj) and several others.***

On the other hand, the Hon'ble Kerala High Court in ***Xavier Pulikkal vs. DCIT [2016] 242 Taxman 206*** had taken a contrary view and had held that for the purpose of exemption under section 54F, the due date prescribed under section 139(1) of the Act should be considered and under section 139(4) of the Act. This decision of the High Court has since been set aside by the Supreme Court. See [2015] 379 ITR 535. In that case, looking at the facts, the Assessing Officer was to be directed by the Apex Court to consider the matter *de novo*, without being influenced by any observation made by High Court. Thus, in light of the Supreme Court decision, the observations of the Kerala High Court can no longer be considered as good law.

XV. INTERPLAY OF SECTION 56(2)(X) AND SECTION 54/54F

If a person for the purpose of investment under section 54/54F, purchases a property say for ₹ 50 lakh and the stamp duty value of such property is ₹ 70 lakh, then the difference of ₹ 20 lakh is subject matter of tax under section 56(2)(x) of the Act in the hands of the buyer. Can, for the purpose of section 54 and 54F, one argue that the cost of the new asset is ₹ 70 lakh and not ₹ 50 lakh?

Section 56(2)(x) is a deeming fiction and it has its limited application. Further, a specific amendment has been made under section 49(2A) of the Act, whereby the SDV of such property is taken as cost of acquisition while computing capital gains on transfer of such new property. Thus, in absence of any such amendment in section 54/54F, it will be difficult to argue that the investment in the new house is the stamp duty value and not the actual purchase price. Further, if allowed, then one can also stretch such argument to the extent that any property gifted to the person and taxed at SDV under section 56(2)(x), amounts to purchase of property by such recipient at the stamp duty value for the purpose of section 54/54F.

Nonetheless, it is also equally arguable that investment for the purpose of section 54/54F should be taken as the stamp duty value especially in cases where the property is purchased for some consideration which is less than the SDV. This is because, once an amount is taxed under section 56(2)(x), then for all practical purposes, such SDV becomes the cost; which is why the provision of section 49(2A) provides for enhanced cost.

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Period of Holding - Date of Acquisition

CA Shailesh M. Bandi

Where a residential property is held by an individual for more than 24 months immediately preceding the date of transfer, any capital gains arising from transfer of such property is considered as Long Term Capital Gain (LTCG). Else, the gain arising from transfer of such property shall be considered as Short Term Capital Gain (STCG).

Thus, it becomes important to determine the date of acquisition for the purpose of calculating Capital Gains tax and ascertaining whether such property is a long term capital asset or short term capital asset. The question become more complex if the said property has been purchased during the under-construction phase.

There may be multiple dates while the property is purchased during the under-construction phase and the payments are made in phases as the construction progresses. During the said period, generally following documents are executed while purchasing an under-construction property

1. Memorandum of Understanding (MOU);
2. Agreement to Sale (ATS);
3. Allotment Letter;
4. Sale Deed or Conveyance Deed including its registration;
5. Letter of Date of Possession.

While the above are the common parlance and some other parlance that may be used by different persons in different regions.

Generally, at the time of booking of the property an MOU is executed, while mentioning all the terms and conditions, which either may be termed as term sheet and is executed based on the plans of the builder which are only in the initial stages but approvals are not in place.

Some builders instead of an MOU, execute an agreement to sale (ATS). It is important to note that an ATS is much different then a Sale Agreement/Sale Deed or Conveyance Deed.

In both the aforesaid cases, there is a promise to execute the transaction for purchase and sale of the property as generally no earmarked flat is mentioned therein as the Approvals are pending. However, in some cases it is seen that the Builders do mention the specific size and flat numbers.

Upon receipt of the approvals, the builder provides a letter of allotment.

In many cases, the position is *vice-versa* i.e. the Lletter of allotment is awarded on the booking of the flats whereas the ATS is entered subsequently.

Thereafter, Sale Agreement/Sale Deed or Conveyance Deed is executed. Upon completion of the construction, the possession is given.

Thus, the issue arises as to

1. In such an acquisition of under-construction property, it is important to ascertain whether the same falls within the definition of Capital Assets or not.

2. If the answer is in affirmative, what is the relevant date of acquisition for calculating the period of holding?

The definition of Capital Asset is given in section 2(14) of the Act. The opening words "Capital Asset" states that the "Capital Asset means property of any kind held by the assessee……". The Said definition is of widest import and it encompasses the property of any kind. The Hon'ble Supreme court in ***G. H. Ariff & others vs. Commissioner of Wealth Tax, Calcutta 76 ITR 47*** held that "Property is a term of widest import and, subject to limitation which the context may require, it signifies every possible interest which a person can clearly hold and enjoy".

The Hon'ble Bombay High Court in the case of ***CIT vs. Vijay Flexible Containers 186 ITR 693*** also took a similar view and held that "the right to obtain conveyance of immovable property falls within the expression 'property of any kind' used in section 2(14) of the Income-tax Act, 1961 and is consequently, a capital asset.

Reading the aforesaid cases and the definition of a capital asset, it is amply clear that the right acquired to obtain conveyance is a capital asset.

This brings us to the question that when such right is acquired, how to determine the date of holding *vis-s-vis* the period of holding i.e., from which date the date of holding *vis-a vis* the period of holding should be calculated from?

1. That while dealing with the similar issue in the case of ***DCIT, Circle-3 (1) vs. Vembu Vaidyanathan in ITA No. 5749/MUM/2013*** wherein the facts are as under

   i. The assessee had claimed long term capital gains on the basis of MOU of sale of flats entered into on 24-4-2008 and the agreement of sale thereto was executed on 17-5-2008. The allotment in respect of the said flat which are offered to long term capital gains were made *vide* allotment letters on 31-12-2004 and the agreements for purchase were entered into 2-11-2006.

   ii. The AO computed the capital gains as short-term further reasons given hereunder:–

      a. the period of holding should be computed from the date of conveyance and not from the date when a party merely agrees to sale.

      b. Agreement of sale executed by the assessee on 17-5-2008 does not refer to allotment letter and therefore the rights and title and interest were transferred to the assessee only on 2-11-2006.

      c. Agreement of sale executed by the developer on 2-11-2006 does not refer to the letter of allotment dated 31-12-2004.

      d. Registration is mandatory under section 4(1) of Maharashtra Ownership Flats Regulation of Promotion of Construction, Sale, Management and Transfer Act, 1963.

e. It is the date of registration that determines the rights of the purchaser and not the date of allotment. The allotment is subject to cancellation and changes but it is only a registered document which is capable of being enforced in a court of law. Hence the contention that the allotment creates an asset in favour of the assessee is without any basis and devoid of merit.

iii. The Hon'ble Tribunal, considered catena of cases, including that of the Bombay High Court in the case of ***CIT vs. Tata Services Ltd. 122 ITR 594*** when the Hon'ble court observed the following:-

"What is a capital asset is defined in section 2(14) of the I. T. Act, 1961. Under that provision, a capital asset means property of any kind held by an assessee, whether or not connected with his business or profession. The other sub-clauses which deal with what property is not included in the definition of the capital asset are not relevant. Under section 2(47), a transfer in relation to a capital asset is defined as including the sale, exchange or relinquishment of the asset or the extinguishment of any right therein or the compulsory acquisition thereof under any law. The word "property", used in section 2(14) of the IT Act, is a word of the widest amplitude and the definition has re-emphasised this by use of the words "of any kind". Thus any right which can be called a property will be included in the definition of "capital asset". It is also assignable. (See* Hochat Kizhakke Madathil Venkateshwara Aiyar vs. Kallar Illath Raman Nambudhiri, AIR 1917 Mad 358*). Therefore, in our view, right to obtain conveyance of immovable property, was clearly "property" as contemplated by section 2(14) of the I.T. Act, 1961".

After considering, various judgements, more particularly of the Bombay High Court quoted above wherein the Hon'ble court went to the extent to state that even right to obtain conveyance of property is a property as contemplated by section 2(14) of the act and thus held that, "the definition of capital asset, under the I. T. Act referring to 'property of any kind' carries no words of limitation, because it is a wide amplitude includes every possible interest that the person may hold and enjoy".

iv. The above case was carried to the Hon'ble Bombay High Court in Income-tax Appeal No. 1459 of 2016 and the Hon'ble High Court vide its order dated January 22, 2019 considered various cases and more particularly the 2 circulars issued by the CBDT and observed as under:–

"4.....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 short) for which allotment letter is issued, the date of such allotment would be relevant date for the purpose of capital gain tax as a date of acquisition. It was noted that such allotment is final unless it is cancelled or the allottee withdraws 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.

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 as under:

"2. The board has considered the matter and has decided 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 imperative of board's Circular No. 471, dated 15-10-1986 such cases may also be treated as cases of construction for the purpose of sections 54 and 54F of the Income-tax Act".

It can thus be seen that the entire issue was clarified by the CBDT in its above mentioned two circulars dated 15th October 1986 and 16th December 1993. 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. There is nothing on record to suggest that the allotment in construction scheme promised by the builder in the present case was materially different from the terms of allotment and construction by D.D.A. In that view of the matter, CIT appeals of the Tribunal correctly held that the assessee had acquired the property in question on 31st December 2004 on which date the allotment letter was issued".

There have been catena of cases on the similar lines wherein the ITAT and the Hon'ble Court has held that the date of acquisition *vis-à-vis* the period of holding should be reckoned from the date of allotment letter.

At this juncture, it is important to discuss another facet i.e., where the MOU or ATS are entered into prior to obtaining of allotment letter or the transaction is sans of allotment letter.

2. The Hon'ble Bombay High Court in ***Amarjeet Thapar vs. Income Tax Officer, Ward 24(1)(1) and Ors. in Writ Petition No. 3548 of 2018*** had considered the following issue:-

   i. what is the date of acquisition in case where an assessee has entered into an agreement to sale but the sale deed could not be executed?

   ii. The facts in relation to the same are as under:-

      a. The assessee, an individual had filed its return of income for A.Y. 2013-14 offering long-term capital gains of ₹ 36,648,582/-after taking the index cost of acquisition based on the year of acquisition shown as 1992.

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b. The assessee had entered into an agreement to sale (ATS) i.e to purchase a house from one Ms. C on 30-10-1992 and the assessee had paid ₹ 650,000 towards Earnest money.

c. The balance amount of ₹ 5,750,000 would be paid upon issuance of NOC by the appropriate authority is referred to in chapter XX-C of the I.T. Act, 1961.

d. The appropriate authority by in order dated 15-1-1993 refused to grant such NOC and ordered the purchase of the same by the Central Government.

e. The assessee challenged the order of appropriate authority by filing writ petition No. 289 of 1993.

f. The Hon'ble Bombay High Court by order dated 4-6-2007 quashing the order of the appropriate authority and directed the income tax department where the possession of the premises and also execute necessary deed of sale and convey the property to the assessee.

g. Against the said order the Income tax department preferred SLP to the Hon'ble Supreme Court which was dismissed.

h. The income tax department handed over the possession on 16-11-2009 which was taken by the appropriate authority in 1993 and thereafter the assessee registered the need of transfer dated 26-4-2011.

i. Subsequently, the assessee sold the said property under an agreement on 27-12-2012 and accordingly offered to long term capital gains by taking the year of acquisition as 1992.

j. The AO considered the year of acquisition as 2007 i.e. it considered the year in which the Hon'ble Bombay High Court had passed an order quashing the order of appropriate authority.

iii. The Hon'ble Bombay High Court considered the decision of the Hon'ble Supreme Court in the case of ***Sanjeev Lal and Ors. vs. CIT, Chandigarh 365 ITR 389*** wherein the appellant assessee had inherited a residential house under a will which was self-acquired property of his grandfather. He had entered in to an agreement to sale (ATS) on 27-12-2002 and received earnest money at that time. Before the sale deed could be executed, one of the relatives challenged the will before the Civil Court. The Civil Court granted an injunction against the execution of sale. The litigation eventually resulted in favour of the appellant and thereafter the injunction was vacated and the sale deed was executed on 24-9-2004. In the meantime, the appellant had purchased a residential house and claimed exemption from capital gains tax on the amount invested by him in purchase of new asset. The Income

Tax Department objected contending that the acquisition of new asset was before the sale of capital asset by assessee and in this context the issue reached before the Hon'ble Supreme court wherein it had to consider the availability of exemption under section 54 read with the definition of transfer of section 2(47) of the I. T. Act.

The Hon'ble SC noted that

"23. In addition to the fact that the term "transfer" has been defined under Section 2(47) of the Act, even if looked at the provisions of Section 54 of the Act which gives relief to a person who has transferred his one residential house and is purchasing another residential house either before one year of the transfer or even two years after the transfer, the intention of the Legislature is to give him relief in the matter of payment of tax on the long term capital gain. If a person, who gets some excess amount upon transfer of his old residential premises and thereafter purchases or constructs a new premises within the time stipulated under Section 54 of the Act, the Legislature does not want him to be burdened with tax on the long term capital gain and therefore, relief has been given to him in respect of paying income-tax on the long term capital gains. The intention of the Legislature or the purpose with which the said provision has been incorporated in the Act, is also very clear that the assessee should be given some relief.

24. Though it has been very often said that common sense is a stranger and an incompatible partner to the Income-tax Act and it is also said that equity and tax are strangers to each other, still this Court has often observed that purposive interpretation should be given to the provisions of the Act. In the case of Oxford University Press vs. Commissioner of Income Tax [(2001) 3 SCC 359] this Court has observed that a purposive interpretation of the provisions of the Act should be given while considering a claim for exemption from tax. It has also been said that harmonious construction of the provisions which subserve the object and purpose should also be made while construing any of the provisions of the Act and more particularly when one is concerned with exemption from payment of tax. Considering the aforestated observations and the principles with regard to the interpretation of statute pertaining to the tax laws, one can very well interpret the provisions of Section 54 read with Section 2(47) of the Act, i.e., definition of "transfer", which would enable the appellants to get the benefit under Section 54 of the Act.

25. Consequences of execution of the agreement to sale are also very clear and they are to the effect that the appellants could not have sold the property to someone else. In practical life, there are events when a person, even after executing an agreement to sale an immovable property in *favour of one person, tries to sell the property to another. In our opinion, such an act would not be in accordance with law because once an agreement to sale is executed in favour of one person, the said person gets a right to get the property transferred in his favour by filing a suit for specific performance and therefore, without hesitation we can say that some right, in respect of the said property, belonging to the appellants had been extinguished and some right had been created in favour of the vendee/transferee, when the agreement to sale had been executed.*

26. *Thus, a right in respect of the capital asset, viz. the property in question had been transferred by the appellants in favour of the vendee/transferee on 27-12-2002. The sale deed could not be executed for the reason that the appellants had been prevented from dealing with the residential house by an order of a competent Court, which they could not have violated."*

iv. The Hon'ble Bombay High Court after considering the above held that though the facts in case of Sanjeev Lal's Case were not identical but were somewhat similar & thus concluded that the ATS was executed in 1992 but the final agreement could not be entered into upon as the appropriate authority refused to grant the NOC and instead ordered compulsory acquisition which later on was held to be illegal and void by the Hon'ble High Court. The High Court there in observed that "there is no reason for us not to accept the petitioner's contention that the execution of the sale deed by virtue of the judgment of the High Court would relate back to the original agreement to sale (ATS). The petitioner was therein entitled to claim the benefit of cost of indexation from the said date."

Here is the question which needs to be considered on each and every given set of facts.

The importance lies in the documents that have been prepared in respect of the property which is under construction, more particularly the documents mentioned at Sr. 1 or 2 or 3 i.e. MOU or ATS or Allotment letter. What is important is that the transaction should be real and not ostensible, which can be only determined by finding out the intention of the parties which must be gathered from the language of the document itself together with the surrounding circumstances. The document should identify the property which is to be acquired i.e., the details of the same mentioned in the MOU/ATS/Allotment letter or not and whether as a result the assessee is receiving the unfettered right to the flat or not.

Thus, the document that irrevocably binds the vendor and vendee, as the owner of the property giving the assessee an unconditional right to the enforce the conveyance of property, pending the possession/full payment, the same may be construed as the date of acquisition of the flat and accordingly the period of acquisition should be calculated therefrom.

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Section 50C

CA Kinjal Bhuta

1. Background & Constitutional Validity

Before introduction of section 50C, there was a long standing practice to evade tax by understating the sale consideration paid on transfer of land and building by paying substantial part of actual consideration with unaccounted (black) money or in cash. The rationale for introduction of section 50C was to prevent the large scale undervaluation of real estate and tax the unaccounted money in transactions.

Similar provision by way of section 52 was introduced earlier in year 1964, which enabled the AO to adopt fair market value according to his opinion as sale consideration subject to valuation by valuation cell on his reference. However, since Supreme Court in case of ***K. P. Varghese vs. ITO (131 ITR 597)***, required proof of understatement of consideration before application of the provision, it lost it effectiveness and got deleted in 1988.

Section 50C was inserted by Finance Act, 2002 with effect from 1-4-2003 to make a special provision for determining the full value of consideration in cases of transfer of immovable property. Under this provision, if the value of property on which stamp duty is paid on registration was higher than agreed value, the former was considered as the full value of consideration for purpose of computing capital gains.

The Constitutional validity of section 50 C was questioned before Madras HC in the case of ***K. R. Palanisamy vs. Union of India & Ors.(306 ITR 61),*** on the ground that income based upon stamp valuation is fanciful and imaginary and that provision is discriminatory the manner in which the state authorities determine the guidelines value are arbitrary. However, it was held by the Hon'ble HC as valid section and that solution lies in a practical application of section 50C without undue weight to the guidelines valuation, which should be merely taken as justifying and enquiry as to the correctness of the value adopted as the consideration agreed as stated in the document and nothing more. The Constitutional validity was also challenged in the case of ***Bhatia Nagar Premises Co-op. Soc. Ltd vs. UOI & Ors. (334 ITR 145)*** before the Hon'ble Bombay HC. The validity was upheld by the Court, by holding that Section 50C is only a measure for levying tax and it will not alter the nature and basis of such tax. Also, a complete safeguard was provided in sub-section (2) of Section 50C and that the principle laid down By Supreme Court in ***Sanyasi Rao case (219 ITR 330)*** was inbuilt in sub-section (2) which permits the authorities to adopt a lower value on the basis of valuation report subject to right of further appeal. These case laws determine the fundamental principles of section 50C and help in analysing various practical issues which come up on application of section 50C.

2. Realm of Section 50C

Sub-section (1) speaks that when consideration received or accrued on transfer of any capital asset being land or building or both is less than the value adopted by stamp valuation authorities for purpose of payment of stamp duty, this value so adopted by the stamp duty authorities shall be considered as full consideration for the purpose of section 48 to compute capital gains.

Fist proviso to this sub-section states that where the date of agreement fixing the amount of consideration and the date of registration for transfer of capital asset are not the same, the value adopted on the date of agreement may be considered for this section. This amendment was made by Finance Act, 2016 which is applicable with effect from AY 2017-18.

Second proviso to the sub-section states that the first proviso shall be applicable only in case where the amount of consideration or part thereof has been received by way of an account payee cheque, bank draft, or by use of ECS through bank account or through any electronic mode as may be prescribed on or before the date of agreement.

Third proviso was introduced by Finance Act, 2018 effective from 1-4-2019 provides for a tolerance limit of 5% over the actual consideration as per the agreement entered into between the parties. It states that when the value adopted/ assessable by the stamp valuation authority does not exceed 105% of the consideration received or accrued as result of transfer, the latter shall be considered as full value of consideration. This is a welcome provision as it shall reduce lot of litigation which was falling within a smaller margin.

Under sub-section (2), the assessee may claim that the value adopted for stamp duty purposes exceeds the fair market value of the property as on the date of transfer and, in such a case, the Assessing Officer if he does not agree with the assessee, should refer the valuation of the property concerned to a Valuation Officer. For the purposes of this section where procedures are involved, various sections of Wealth Tax Act, 1957 are referred to. Sub-section (3) provides that if the valuation arrived by the valuation officer exceeds the stamp duty valuation, than the stamp duty value shall be considered as full consideration for purpose of this section.

3. Does word "may" in sub-section (2) give the AO discretion to refer and not a case to the DVO considering that both ingredients under the sub-sections are present?

The word in section 50C which talks about 'may' shall be understood as 'should' when it comes to reference to the DVO when there is a dispute in the value of transaction as held in the case of ***CIT vs. Chandra Narain Chaudhri (38 ITR 275).*** The word further signifies that even in case the AO is not satisfied with the explanation of the assessee, he 'should' refer the matter to the DVO (114 TTJ 814). ITAT Hyderabad in case of ***ACIT vs. Lalitha Karan (1 TMI 505)***, held that the AO cannot simply brush aside the submissions of the assessee while adopting the value as mentioned by the SVA. Sub-section (2) imposes a statutory duty on the AO to obtain the value of the capital asset by referring the matter to the DVO. It was held by Mumbai ITAT in the case of A. T. E Enterprises P. Ltd (55 SOT 175), that once, the assessee objects to the stamp duty value, the words 'may' should be treated as 'shall'.

However, the onus to show that stamp duty valuation is higher than fair market value is on the assessee, therefore it is necessary for assessee to object the stamp duty value before the AO. The provisions under section 50(2) has to be invoked by the assessee. The AO has a duty to refer to the valuation officer only if the assessee challenges the stamp duty valuation before the AO. The same is held in ***Sanjaybhai Patel vs. ACIT (48 SOT 231)*** and in case of ***Ambattur Clothing Co Ltd. vs. ACIT (326 ITR 248)***.

Report by registered valuer is binding on the Assessing Officer but not on the appellate authorities, they can come to their own conclusion as to proper value on the basis of evidence available and law on the subject. This ratio was held by Chennai Tribunal in the case of ***ACIT vs. MIL Industries Ltd. (21 ITR (Trib.) 627).***

4. Interplay with section 56(2) (x), does it lead to double taxation?

Section 56(2)(x) taxes the recipient of any immovable property without consideration or inadequate consideration. Therefore, where section 50C charges the seller of the property by considering the stamp duty valuation of the property as full consideration for purpose of computing 'Capital Gains', section 56(2)(x) charges the buyer of the property the difference between the fair market value and the purchase price of property as 'Income from Other Sources'.

In the existing framework of the Income-tax Act, for the same income or rather the deeming income, both the seller and the buyer of land and/or building, are being taxed twice and as such the pressing of service of such deeming fiction of taxation both in the hands of the seller and/or buyer of land and/or building is resulting in "Double Taxation". This 'double taxation' is contrary to the well-established and well settled principle of Law and canons of direct taxation that "a same income can't be taxed twice."

5. What can be the scenario in case of genuine reasons to sell property at less than stamp duty valuation?

There may be cases when the property is sold at lesser than fair market value because of various practical reasons. Some of the reasons are auction sale, compulsory court sale, sale of property where there is pending litigation with respect to title or possession, property where old tenants needs to be evacuated which will involve additional cost. A sale in nature of compulsory public auction or a compulsory sale under court order are the ones where the consideration cannot be challenged ordinarily. On-money payment cannot be inferred on such sales. In such cases the Assessing Officer is bound to exercise his discretion and accept the value decided in open sale as real value.

In a classic case before the Chennai ITAT in case of ***ACIT vs. Royal Stitches Pvt Ltd. (TS-5283-ITAT-2010),*** it was held by the Tribunal, the assessee had challenged the stamp valuation before the AO on the grounds that title of the property was in dispute due to various pending legal proceedings, in such scenario, the DVO when he is exercising the powers vested on him for valuation of the asset in accordance with sub-section (2) of section 50C of the Act, is duty bound to give an opportunity to the assessee to present its case for valuation of the asset. If the assessee is able to show that the title was defective or that there was drag in market value of the property, due to the litigation with the so called confirming parties, then, of course, the DVO would have to consider such plea of the assessee and decide in accordance with law.

However there are no exceptions for such scenarios under section 50C. The only resort available is to challenge the stamp duty valuation before the state authorities or the AO or to get the valuation done by registered valuer giving sufficient reasons as to why this property should be valued less as compared to the fair market value of similar properties.

6. Applicability of section 50C to unregistered agreements or documents

Section 50C required the adoption of value which is determined by stamp duty authorities for payment of stamp duty on registration of documents or agreements. There was an anomaly as to what shall be the stamp duty valuation for purposes of section 50C for the agreements which are not registered and on which stamp duty has not been paid. This led to a round of confusion and chaos and therefore with effect from 1-10-2009, section 50C was amended to use the words 'assessable' in section 50C. By this amendment, the agreements whereby the property is transferred but are not registered shall also fall within the ambit of section 50C. The Madras High Court in case of ***CIT vs. R. Sugantha Ravindran (352 ITR 488)*** has held that this amendment is prospective in nature and therefore cannot be applied to transactions before October 2009.

7. What if assessee has challenged the stamp duty valuation to stamp duty authorities?

The seller can challenge the stamp valuation authorities against the valuations derived. As per section 155(15) of the Income-tax Act, 1961, where capital gain is computed by adopting the stamp valuation u/s. 50(1) of the Act, and such value is revised in any appeal or revision or reference referred to in section 50C(2)(b), the AO shall amend the order of assessment to adopt the revised value by adopting the provisions of section 154 and the period of four years shall be reckoned from the end of previous year in which the order revising the value was passed in appeal or revision or reference.

8. Is section 50C applicable to rights associated with immovable property?

Section 50C specifically mentions its applicability to transfer of capital asset being 'land or building' or both. Section 2(14) of the Act defines capital asset which means property of any kind held by the assessee. The definition is exhaustive and wide and may include even the rights in those properties. Though the words in section 50C are clear that it applies to land and building or both, there has been controversies in the past that whether right in land or building also falls under the bracket of this section or not. There are various rights closely linked to the land and building like tenancy rights, leasehold rights, development rights or Transferrable Development Rights (TDR). These rights can be sold separate too and may not be sold with the land and building to which they are attached. The normal settled law is that section 50C would not apply to these rights as section is clear to provide only for land and building. If we compare it with section 54D which is with regards to compulsory acquisition of property, the said section specifically mentions about land or building and any right in land or building. This shows that where legislature wanted to include rights, it has been specially mentioned, the fact that it has not been mentioned in section 50C is intentional so as to not include rights in land and building under the purview of section 50C. This view is also supported by various case laws. In case of Prem Rattan Gupta (ITA No. 580/M/2009), it has been held by Hon'ble Mumbai ITAT that consideration received on transfer of TDR/additional FSI granted on account of land acquisition cannot be subject matter of section 50C as there is no transfer of land and building. Though FSI and TDR granted are considered as immovable property but they cannot be considered as land or building for the purposes of section 50C of the Act. In the case of ***Atul Puranik vs. ITO (132 ITD 499),*** it was held by ITAT that section 50C is not applicable to assignment of leasehold rights. Leasehold/ tenancy rights in land and building cannot be equated with land and building under section 50C and accordingly section is not applicable to the leasehold rights. Tenancy Right is not right *in rem* but it is a capital asset, the surplus on sale of which is liable for capital gains tax, in ***DCIT vs. Tejinder Singh (16 ITR (Trib.) 468)***, it was held that, when the assessee is a tenant received an amount as compensation for loss of tenancy rights on transfer of ownership in the property by the lessor to third party, there is liability for capital gains on the assessee, a lessee in respect of transfer of leasehold rights, but section 50C is not applicable. There have been several judgments regarding this matter, and now it is more or less settled that section 50C is not applicable to rights in land and building. However Mumbai Tribunal in ITA No. 541/Mum/2010 in the case of Arif Akhtar Husain has held that s. 50C applies in the case of transfer of development rights. Also, if land and building are actually transferred under the garb of transfer of rights intrinsic to land and building, then section 50C may apply to such cases and such transactions shall not be governed by the nomenclature used in the agreement or contract/document and substance shall prevail over form in such cases.

9. Applicability of section 50C to deductions u/s. 54, 54F and 54EC etc.

There are certain sections in which deduction from capital gains is allowed based on the investments of capital gains or sale consideration of the property. Issue can arise where an assessee transfers residential building and proposes to invest the capital gain in another residential house so as to claim exemption u/s. 54. Should the assessee invest the capital gains computed on the basis of real consideration or on the basis of deemed consideration is a practical issue to be addressed. Literal application and interpretation indicates that capital gains computed on the basis of stamp duty value (wherever applicable) to be invested and therefore will result in litigation. In case of ***Subash Chand vs. ACIT 18 taxmann.com 149 (ITAT-Chandigarh)***, it has been held that, the consideration, which is deemed by sec. 50C to have been received by the transferor, is for the limited purpose of computation of capital gains u/s. 48 and for no other purpose. It cannot and does not mean that the said amount of consideration has been actually received by the assessee or actually paid by the transferee to him so as to be available in his hands for investments or for meeting the expenses. "Deemed consideration" u/s. 50C for computation of capital gain u/s. 48 is quite different from actual consideration or actual availability of money for the purpose of making investments or for meeting the expenses. Deemed consideration within the meaning of sec. 50C cannot and does not mean that the amount of deemed consideration has actually been paid by the transferee or actually received by the assessee. The main issue may arise in section 54F where deduction is based on the investment in the net consideration and not the capital gains unlike the other deduction sections. In case of ***Gouli Mahadevappa vs. ITO (128 ITD 503)***, it has been held that section 50C is not applicable to section 54F. Sec. 54F requires investment of “net consideration”. Net consideration is defined as the “full value of consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer”. In view of this, what is relevant for the purpose of sec. 54F is the reinvestment of the net amount actually realised and not any notional amount as may be adopted by virtue of sec. 50C. This view is upheld by the Jaipur Tribunal in the case of ***Gyanchand Batra vs. ITO(133 TTJ 482).*** Also, in case of ***CIT vs. Ace Builders P Ltd. (281 ITR 280)***, the Bombay HC in context of provisions of section 50 and 54E, has held that the deeming fiction in one section does not automatically apply to all other provisions of the Act. However, in case of *Mohd. Sahib vs. DCIT,* the Tribunal has held that where no claim was made before the AO and where its adoption was not disputed, the assessed capital gains should be treated as available for investment. In a recent judgment rendered by Bombay HC, in case of ***Jagdish Dhabalia vs. ITO (TS- 143-HC-2019),*** it was held that section 50C shall be applicable even in case entire consideration was invested in 54EC Bonds, and observed that the deeming fiction under section 50C of the Act must be given its full effect while computing capital gains, even where the entire capital gain has been claimed as exempt because of investment in eligible bonds. Any other interpretation would render the provisions of section 50C be redundant. This decision is in striking contrast to various other decisions at Tribunal level where it has been held that section 50C is deeming provision and artificial meaning of full value of consideration and should not apply to other provisions of Act. The law on this subject is not settled yet, and requires some statutory clarification.

10. Applicability of section 50C to section 69A, 69B, etc. in hands of buyers

The stamp valuation adopted for section 50C cannot *ipso facto* be a legitimate ground for concluding that there was under valuation in acquisition of property and no addition can be made u/s. 69B of the Act. In the case of ***ITO vs. Optec Disc Manufacturing (2008) 11 DTR 264 (Chd.)(Trib.)*** it was held that adoption of different value for stamp duty purposes cannot by itself distract from the consideration stated in the sale deed. Fiction created under S. 50C is applicable only for computing capital gains in the hands of seller and does not apply to buyer for invoking S. 69B. Similar decisions have been rendered by the Ahmedabad Tribunal holding that in the case of purchaser of the property, s. 50C cannot be invoked. The same rationale is also held in ***CIT vs. Khoobsurat Resorts P Ltd. (256 CTR 371)***, in ***ITO vs. Mrs. Inderjit Kaur (50 SOT 377)*** and many other case laws who have held a similar rationale. Hon'ble Madras High Court in ***CGT vs. R. Damodaran (2001) 247 ITR 698 (Mad.)*** held that Stamp Valuation Authorities have their own method of evaluating the property. Merely because for the purpose of stamp duty, property is valued at higher cost, it cannot be said that assessee has made more payment than what is stated in the sale deed. Hon'ble Supreme Court in ***CIT vs. Mother India Refrigeration Industries (P) Ltd. (155 ITR 711)*** held that legal fictions are created only for some definite purpose and they must be limited to that purpose and should not be extended beyond that legitimate field.

However, though it may not be applicable for purposes of sections 69A, 69B etc., section 56(2)(x) charges the difference in the consideration and the FMV (assessable stamp value) of the value of immovable property in the hands of the purchaser as income.

11. Penalty u/s. 271(1)(c) and section 270A in case of additions under section 50C

There is no presumption that a person receives more than what is indicated in the registered document. It is the burden of the person who alleges extra consideration to prove that there has been a larger receipt, than what is indicated in the document. Section 50C does not make any difference to this position of law. It does not shift the entire burden on the assessee to show that there is no under-statement of consideration. In ***CIT vs. Madan Theatres (260 CTR 75)***, the HC held that revenue failed to produce an iota of evidence that assessee actually received one paise more than the actual consideration shown to have been received by him and the proceedings cannot start based on Deemed Consideration.

The Income-tax return form now has a separate field to mention the full consideration to be adopted as per section 50C. Most of the assessees would enter the actual consideration received as full consideration u/s. 50C. The moot question here is that can there be a case of misreporting or under reporting if the Assessing Officer chooses the case for scrutiny and the assessment results into adoption of higher sale consideration as reported in the return of income. One may argue that with lack of instructions to return forms on this aspect on what can be the implications of section 50C, the revenue cannot expect the assessee to report the stamp duty value as the full consideration value under this field. Further, the assessee may on purpose state the actual consideration as full consideration for purposes of section 50C as he may consider that stamp duty value is higher than fair market value. These can be few of the grounds to defend penalty under the new section 270A for misreporting or under-reporting of income.

12. Applicability to slump sale

Section 50B applied to transfer of capital asset being an undertaking or division. This section is very specific provision which compasses both the assets and liabilities of the capital asset i.e. the undertaking. The business is sold as a going concern along with real property, real property is separately registered at a notional value for giving title to the successor, while the sale of business as going concern is carried out by a document which itself is not registered. Section 50C is clear to make it applicable only to land and building and it does not extend to undertaking. In case of ***Summit Securities Ltd. (135 ITD 99)***, it has been held that, *explanation* 2 to section 2(42C) makes it very clear that determination of value of asset or liability for the purposes of payment of stamp duty etc., shall not be regarded as assignment of values to individual assets or liabilities. Therefore it is clear that even if the undertaking comprises only of land or building or both, still no stamp duty shall be considered as far as the computation of whole undertaking is concerned. Section 50B does not mention anywhere that fair market value should be considered to determine the full value of consideration, therefore it can be fairly construed that section 50C does not apply to slump sale.

13. Applicability to depreciable assets

In the case of ***ITO vs. United Marine Academy (9 ITR 639),*** it has been held by the Special Bench of Mumbai that section 50C provisions are applicable to transfer of depreciable assets covered u/s. 50 also. The legal fiction created u/s. 50C is for full value of consideration and legal fiction created u/s. 50 is for cost of acquisition. Hence, both legal fictions are in different fields and do not conflict with each other. However, still the issue is that the section 50C provision should be invoked at the time of ascertaining the excess net consideration or after such excess is ascertained.

Conclusion

The present provision of section 50C provides two remedies to the assessee *viz*: that he can either file appeal against the stamp value or he can seek reference to valuation officer. Adoption of value to the valuation officer again is subject to regular appeals available against the order of Assessing Officer. It is under these circumstances, that there is additional burden cast on the taxpayer to prove the apparent agreed consideration when it is lower to the stamp valuation. Such burden may be necessary in light of the need for tackling tax evasion widely prevalent by way of unaccounted income finding their way to real estate investments. The provisions may be draconian but may be necessary in larger interest of economy. The assessee therefore should try to be set the agreed consideration closely to fair market value and if at all there is reason to agree to a consideration at lesser value, there should be in place a valuation report from an independent registered valuer recording reasons agreeing to lesser sale consideration of the property to the fair market value before the same is referred to the valution officer by the AO. These timely actions and preventive measures may help assessee in longer run to avoid and reduce litigation and complexities.

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Section 56(2)(x) – Taxation issues with respect to Immovable Properties (from personal taxation point of view)


CA Abhitan Mehta & CA Bhavna Doshi

Scope of Section 56(2)(x)

Section 56(2)(x) primarily is a gift tax on the donee. S. 56(2)(x) would treat receipt of immovable property[1] or specified property or sum of money without consideration or for inadequate consideration (not sum of money) as income of the recipient. In case of receipt of immovable property, income u/s. 56(2)(x) would be computed considering the stamp duty value of such immovable property less consideration (if any) paid for acquisition of such immovable property.

Monetary Threshold

The monetary limit prescribed for applying S. 56(2)(x) is ₹ 50,000 or 5% of consideration whichever is higher i.e. S. 56(2)(x) will not apply if the value of immovable property received without consideration is less than ₹ 50,000 or if the difference between the stamp duty value and consideration paid for acquisition of immovable property is less than ₹ 50,000 or 5% of the consideration paid for acquisition of such immovable property, S. 56(2)(x) will not apply. It is pertinent to note that for calculating income u/s. 56(2)(x), ₹ 50,000 or 5% of the consideration is not a standard deduction i.e., if the difference between the stamp duty value and consideration is higher than the threshold [₹ 50,000 or 5% of the consideration (whichever is higher)], such difference (without any further deduction [₹ 50,000 or 5% of the consideration] would be chargeable to income tax.

Statutory Exemption

The Proviso to S. 56(2)(x) provides for certain categories of receipts of property or sum of money to which S. 56(2)(x) will not apply even if the receipt by the taxpayer is without consideration or for inadequate consideration. The Proviso excludes the application of S. 56(2)(x) *inter alia* to receipt from any relative[2], receipt on the occasion of the marriage of the individual, received under a will or by way of inheritance, receipt in contemplation of death of the donor, receipt on total or partial partition of HUF and an

1. shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art and bullion
2. relative means,–

    (A) spouse of the individual;

    (B) brother or sister of the individual;

    (C) brother or sister of the spouse of the individual;

    (D) brother or sister of either of the parents of the individual;

    (E) any lineal ascendant or descendant of the individual;

    (F) any lineal ascendant or descendant of the spouse of the individual;

    (G) spouse of the person referred to in items (B) to (F); and

Individual settling property on a trust created solely for the benefit of relatives of such individual.

The specified exclusions are wide enough to cover general instances wherein an Individual is likely to receive immovable property without consideration or for inadequate consideration. One of the instances which ought to have been included in the list of exclusisons would be a receipt pursuant to a family settlement/ arrangement. In the author's view, even in absence of a statutory exclusion, S. 56(2)(x) would not apply on receipt of immovable property pursuant to a family settlement/ arrangement but a statutory exclusion would have reduced litigation on the subject.

Family Arrangement/Family Settlement

- Family arrangement is based on the assumption that there is an antecedent title of some sort in the parties and the agreement acknowledges and defines what that title is[3]. An antecedent title would be assumed in a person who may not have any title but who has been allotted a particular property by other party to the family arrangement by relinquishing his claim in favour of such a donee[4].

- Once it is accepted that a recipient of property pursuant to a family arrangement had an antecedent title to the property, the transfer of property in the name of such recipient is a mere correction of the legal title i.e., only recognising the recipients pre-existing right/ownership/ title over the property. Therefore, a change of registered owner of a property pursuant to family arrangement only tantamounts to working out of the pre-existing right[5] of the recipient in the property therefore, not without consideration and consequently, cannot be said to be receipt[6] (the transferee always had antecedent title, it is only an official recording of the antecedent title).

- Following case laws under the Gift Tax Act have held that gift tax is not levied in case of change of registered owner of property pursuant to family settlement/ family arrangement/settlement of family dispute–

  - o ***Commissioner of Gift-tax, Mysore vs. Smt. S. Parvathamma***[7]
  - o ***Ziauddin Ahmed vs. Commissioner of Gift-tax*** [8]
  - o ***Commissioner of Gift-tax vs. S. N. Zaman and S.M. Elahi*** [9]
  - o ***Commissioner of Gift-tax vs. Pappathi Anni*** [10]
  - o ***Commissioner of Income-tax vs. R. Nagaraja Rao***[11]

Trigger of Section 56(2)(x) – time of receipt?

- S. 56(2)(x) is triggered when a person 'receives' immovable property. Therefore, for application of S. 56(2)(x), It becomes crucial to determine the point of 'receipt' of immovable property. Possible views on point of receipt of immovable property –

3. Sahu Madho Das AIR 1955 SC 481
4. *Kale vs. Deputy Director of Consolidation AIR 1976 SC 807*
5. *DCIT vs. Paras D. Gundecha [2015] 155 ITD 880 (Mumbai Trib.)*
6. *Commissioner of Income-tax vs. R. Nagaraja Rao [2013] 352 ITR 565 (Karnataka HC) – Gift Tax Case*
7. [2009] 316 ITR 438 (Karnataka HC)
8. [1976] 102 ITR 253 (Gauhati HC)
9. [1996] 221 ITR 842 (Gauhati HC)
10. [1981] 127 ITR 655 (Madras HC)
11. [2013] 352 ITR 565 (Karnataka HC)

- o Date of Agreement to Sell
- o Date of discharge of consideration & handover of possession of immovable property
- o Date of registration of Sale Deed/ Transfer Deed

Before discussing the three possible views on date of receipt of immovable property, it would be pertinent to note that S. 56(2)(x) provides that in case the date fixing the consideration for the transfer of immovable property (i.e. generally the date of agreement to sell) is different from date of actual transfer of immovable property (i.e., generally date of registration of sale deed), the stamp duty value of the immovable property on the date of agreement to sell should be considered for S. 56(2)(x) subject to the whole or part of the consideration was paid to the transferor through the specified banking channels on or before the date of agreement to sell.

o Date of Agreement to Sell

– At this juncture, the buyer/ transferee only gets a right to acquire immovable property[12] and does not receive immovable property. Therefore, date of agreement to sell cannot be considered to be the date of receipt of immovable property[13].

o **Date of discharge of consideration & handover of possession of immovable property vs. Date of registration of Sale Deed**

– It is a grey area and both views are possible but the author feels that the better view would be to take the date of registration of sale deed as the point of receipt of immovable property in the context of S. 56(2)(x). Reasons–

- The proviso to S. 56(2)(x)(b) in the context of relevant date for determining the stamp duty value of immovable property, considers date of agreement to sell and date of registration (i.e., date of registration of the sale deed) as relevant dates. In other words, the proviso does not consider the date of discharge of consideration/date of handover of possession as a crucial/ important event which would trigger S. 56(2)(x). Therefore, it can be said that the legislature has itself considered the date of registration as the trigger point for S. 56(2)(x) and through the proviso has given a relief to the taxpayer by giving an option to adop stamp duty value on the date of agreement to sell (subject to specified condition) for computing income u/s. 56(2)(x).
- Further, in the context of 'transfer' of capital asset (relevant for charging capital gains tax), the definition of transfer u/s. 2(47) was amended to insert a specific deeming fiction (sub clause (v)) that transfer of possession of immovable property of the nature referred to in S. 53A of the Transfer of Property Act, 1882 would be deemed to be a 'transfer' and consequently, trigger capital gains tax. Prior to amendment of the definition of transfer, Supreme Court[14] had held that, 'transfer' must mean effective conveyance of the capital asset to the transferee, delivery of possession of immovable property cannot by itself be treated as equivalent to conveyance of the immovable property. Presently, the deeming fiction u/s. 2(47) is only for transfer of capital asset and doesn't extend to receipt of capital asset which is the

12. Whether right to acquire immovable property i.e. a right relating to the immovable property is discussed separately under the heading - scope of the word 'immovable property'.
13. *Sanjay Dattatraya Dapodikar vs. ITO [2019] 107 taxmann.com 219 (Pune-Trib.)*
14. *Alapati Venkataramiah vs. CIT [1965] 57 ITR 185 (SC)*

trigger for S. 56(2)(x) and therefore, the ratio of the Supreme Court ruling should apply in the context of S. 56(2)(x).

- **Scope of the word immovable property**

  o In relation to interpretation of S. 56(2)(x), scope of the phrase 'immovable property' is one of the most challenging issue. The concern is primarily the manner in which S. 56(2)(x) is drafted. In brief –

    – ***Charging Part*** of S. 56(2)(x) states – receipt of 'any immovable property' without consideration or for inadequate consideration;

    – ***Computation Part*** of S. 56(2)(x) states – value of the immovable property for the payment of stamp duty to Central or State Government; and

    – ***Exclusion Part*** – Proviso to S. 56(2)(x) states – certain categories of receipts of property to which S. 56(2)(x) will not apply. The word 'property' is defined to mean a <u>capital asset</u> for the tax payer including an immovable property <u>being land or building or both</u>.

  o In other words, charging section has the widest coverage i.e. any immovable property whereas the computation part restricts the scope to immovable property of which a valuation is possible for payment of stamp duty to Central or State Government. Therefore, the Computation Mechanism would exclude/fail if the immovable property does not have a stamp duty value. For example immovable property located outside India. The proviso further restricts the scope of the word immovable property i.e. the immovable property should be capital asset + being land or building or both. Therefore, excluding stock-in-trade (not being a capital asset) from the scope of immovable property and also immovable property other than land or building for examples mines, oil rigs etc.

  o The primary issue is whether the scope of the phrase 'immovable property' used in the charging section has to be restricted to immovable property located in India (computation part) and/or immovable property being land or building or both and also has to be a capital asset of the tax payer (exclusion part).

  o **Computation Part** – It is an accepted position that if a receipt is outside the computational mechanism, the charging section will also not apply[15].

  o ***Exclusion Part*** – In the context of S. 56(2)(x), there would be great difficulty if the scope of charging provision is wider than the scope of the exclusion provision. This can be understood from an example – if a father gifts land to his son which is capital asset for the son, S. 56(2)(x) will not apply on receipt of land from the father, but if the land is stock-in-trade for the son, S. 56(2)(x) would apply on receipt of such land from the father. Therefore, a view supporting the scope of S. 56(2)(x) being wider than the exemption provision would lead to absurdity (*Reductio ad Absurdum*). It is an accepted rule of construction that where the plain

15. *CIT vs. B.C. Srinivasa Setty) ([1981] 128 ITR 294 (SC) & Keva Industries (P.) Ltd. vs. ITO [2019] 112 taxmann.com 137 (Mumbai-Trib.)*

literal interpretation of a statutory provision produces a manifestly absurd and unjust result which could never have been intended by the Legislature, the Court may modify the language used by the Legislature or even do some violence to it, so as to achieve the obvious intention of the Legislature and produce a rational construction[16]. Therefore, in the context of S. 56(2)(x), scope of the phrase 'immovable property' for the charging part and the exclusion part ought to be the same. Though a contrary view i.e. scope of the phrase 'immovable property' for the charging part is wider than the scope of the phrase 'immovable property' for the exclusion part has been expressed by the Tribunal without considering the ramifications of such a view, with due respect the decision of the Tribunal needs reconsideration[17].

o Scope of the word immovable property for the exemption part –

 – **Meaning of the words capital asset** – S. 2(14) defines capital asset to exclude specified agricultural land. Whether in the context of S. 56(2)(x) also, agricultural land which is excluded from the definition of capital asset u/s. 2(14), would be outside the scope of S. 56(2)(x)?

 The opening phrase of S. 2 states that, "In this Act, unless the context otherwise requires . . ." The author cannot think of a reason which would justify, in the context of S. 56(2)(x), an interpretation of the word 'capital asset' different from the definition of capital asset u/s. 2(14).

 – Meaning of the word 'land or building or both' – Similar phrase is used in S. 50C and it is an ongoing controversy whether the phrase 'land or building or both' would also include right in land or building (e.g., lease hold right)[18].

Conclusion

S. 56(2)(x)(b) is technically only a sub-clause but as discussed is this Article, the sub-clause has umpteen number of issues. Author feels that the issues discussed in this Article are only the tip of the iceberg and as the law develops, many more issues would surface in relation to interpretation of S. 56(2)(x).

16. *Luke vs Inland Revenue Commissioner [1963] AC 557 – referred & relied in the case of – K. P. Varghese vs. ITO [1981] 131 ITR 597 (SC)*
17. *ITO vs. Trilok Chand Sain [2019] 174 ITD 729 (Jaipur - Trib.)*
18. 50C will not apply
 - Development rights - *Voltas Ltd. vs. ITO [2016] 74 taxmann.com 99 (Mumbai Trib.)*
 - Lease rights 60 years - *Atul G. Puranik vs. ITO [2011] 141 TTJ 69 (Mumbai Trib.)*
 - Lease rights – *PCIT vs. Kancast Pvt. Ltd. [2018] TIOL 845 (Bom HC)* – appeal admitted
 - Right of Allotment/Right to Purchase – *ITO vs. Yasin Moosa Godil [2012] 52 SOT 344 (Ahmedabad Trib)*

 50C will apply
 - Perpetual lease right – *Rajesh Gupta HUF vs. PCIT [2018] TIOL-826-(Del HC)*

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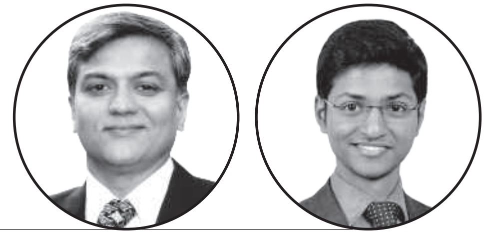
Sole Proprietory Business



CA Haresh Chheda & CA Amit Sawant

Introduction

A Sole Proprietorship is one of the oldest and most common type of business entity. It is the simplest business form under which business is owned and operated by a single individual but it may also lack some of the legal and financial protections that are usually available to other legal entities. A unique feature of sole proprietorship is that there is no distinction between individual and business whereas in all other kinds of structures an entity is interposed between individual(s) and business, be it collective individuals or artificial/ legal entity.

This article highlights certain challenges and issues with respect to taxation faced by the proprietor with respect to immovable property because of lack of distinction between personal property and business property. The article also endeavours to summarise some historical judgments providing clarifications on the development, intention and interpretation of the Income-tax Act, Rules and the circulars and notifications issued thereunder.

1. Concept of Partial or Joint Ownership

- Many a times it may so happen that the immovable property is only partly owned by the assessee. This concept of partial ownership caused difficulty in claiming depreciation in the past. The Supreme Court in the case of Seth Banarasi Das Gupta[1] held that depreciation cannot be claimed in respect of fractional ownership of the assets. In order to extend the benefit of depreciation in respect of fractional ownership, section 32(1) of the Income-tax Act, 1961 ('the Act') was suitably amended by the Finance (No. 2) Act, 1996 with effect from 1st April 1997 so as to allow depreciation not only in respect of assets 'wholly' owned by the assessee but also in respect of assets 'partly' owned by him and used for the purposes of his business or profession.

2. Mandatory claim of depreciation

- Section 32(1) of the Act provides for deprecation on the block of assets that are owned wholly or partly by a person and used for his business or profession.
- One of the tax issue with respect to this is whether the claim of depreciation is mandatory or optional for assessee. The Supreme Court in the case of

1. *Seth Banarasi Das Gupta vs. CIT [1987] 64 CTR 142 (SC)*

Mahendra Mills[2] held that the depreciation is optional and it cannot be forced upon the assessee by the assessing officer.

- Depreciation being an allowance, reduces the profit and thereby leads to a lower tax. Thus, one question to be looked into is why the assessee would not want to claim an allowance which is actually beneficial. One of the possible reason can be that by not claiming depreciation for a particular year, the profits of the assessee would be that much higher which will enable the set off of carry forward business losses which might otherwise lapse. Another reason can be if in a particular year, the gross total income is not sufficient to absorb the deduction available under Chapter VIA, by not claiming depreciation for that year, the assessee would be able to absorb the deduction. Also one may opt for not claiming depreciation in order to obtain the benefit of long term capital gains like lesser tax rate of 20%, indexation and exemptions under section 54 of the Act.

- Subsequently, *Explanation* 5 to section 32(1) of the Act was inserted by Finance Act 2001, with effect from 1st April 2002 which provides that the provisions of section 32(1) of the Act shall apply whether or not the assessee has claimed the deduction for depreciation in computing the total income. In other words one can conclude that depreciation shall be compulsorily granted to the assessee irrespective of whether the same is claimed by him or not.

- The *Explanation* 5 is for sub-section (1) of section 32 and hence it will also apply to depreciation on the assets of the undertaking engaged in generation or generation and distribution of power, additional depreciation to eligible assessee subject to fulfilment of the requisite conditions. This view was supported by the Delhi High Court in the case of Vedanta Ltd[3] that *Explanation* 5 to section 32(1) of the Act, which provides for mandatory claim of depreciation is also applicable to additional depreciation allowable under section 32(1)(iia) of the Act. Accordingly, the High Court held that the claim of additional depreciation is mandatory under the provisions of the Act whether or not the tax payer has claimed such depreciation.

- Having said this, further question arises incase of sole proprietorship where separate accounts and balance sheets are maintained for personal and business affairs. Many a times immovable property used for the purpose of business is classified and shown in personal balance sheet. Consequently, depreciation is not claimed for years together. Subsequently when the said property is sold and capital gains are offered to tax after indexation as long term capital gains the assessing officer then can deny the claim and thrust of depreciation.

- Depreciation allowance in following special scenarios:

  o As per section 35(2)(iv) of the Act no depreciation shall be allowed for those assets which qualify for deduction under section 35(1)(iv) of the Act (i.e. capital expenditure in respect of scientific research related to business of the assessee).

2. *CIT vs. Mahendra Mills [2000] 159 CTR 381 (SC)*
3. *Vedanta Ltd vs. Principal CIT [2018] 93 taxmann.com 392 (Delhi)*

- o When the immovable property is acquired for business use, but due to certain extraneous circumstances is not put to use, the question will arise that, whether depreciation can be claimed. One can argue based on the decision of Madras High Court in the case of Chennai Petroleum Corpn. Ltd[4] that depreciation will be allowed once asset is ready for use even though not actually put to use due to certain extraneous circumstances.

3. Use of immovable property for business and personal purpose

- According to section 38(2) of the Act, if any asset is partly used for business or profession and partly for personal purpose then only proportionate depreciation can be claimed by the assessee. In case where the assessee owned only one asset or when there was no concept of block of assets, there was no difficulty in making proportionate disallowance for personal use.

- Applicability of the above provisions imposed hardship after the concept of block of assets was introduced by the Finance Act, 1988, wherein depreciation has to be claimed on the entire block of assets instead of individual assets. If there are many assets and only some of them are used for personal purpose, the amount of disallowance may have to be estimated on a reasonable basis. It was held by ITAT Chandigarh Bench in the case of Singla Agencies[5] that disallowance under section 38(2) shall be applicable even if it is difficult to estimate the proportionate value of the asset that is used for a purpose other than business or profession. A similar opinion was upheld by the ITAT Chandigarh Bench in the case of Gulati Saree Centre[6].

- As per section 43(6) of the Act, while computing Written Down Value ('WDV') of such block of assets, only that portion of depreciation which is actually allowed/ given effect to is to be deducted[7]. It implies that the amount of depreciation disallowed should not be reduced from the block of assets.

4. Sale of property used for business and acquisition of another property

- Any person carrying on business or profession shall be eligible for depreciation under section 32(1) of the Act only if the block of assets is positive (in terms of value) on the last day of the previous year and the block must exist (in terms of quantity) on the last day of the previous year. Thus for the purpose of claiming depreciation it is necessary for an assessee to have a positive block of assets on the last day of the previous year. If the above mentioned conditions are not satisfied cumulatively, then the benefit of provisions of section 32(1) of the Act shall not be available and provisions of section 50 of the Act (i.e. computation of capital gains on transfer of depreciable asset) shall become applicable.

- Sometimes it may happen that the block contains only one immovable property and there is time lag between sale of such property and acquisition of new property.

4. *CIT vs. Chennai Petroleum Corpn. Ltd. [2013] 358 ITR 314 (Madras)*
5. *Singla Agencies vs. Assistant CIT [1997] 60 IDT 410 (Chandigarh)*
6. *Gulati Saree Centre vs. Assistant CIT [1999] 71 IDT 73 (Chandigarh)*
7. *CIT vs. Straw Products Ltd [1996] 60 ITR 156 (SC)*

If the new property is not registered in the name of assessee by the last day of the same year there shall be no block of assets available on the last day of the year and accordingly no depreciation can be claimed for that year.

- However in the above case if the assessee has acquired the possession and is able to use the property for the purpose of his business or profession and even though the property is not transferred in the name of assessee till the last day of the year, he shall be able to claim depreciation. Registration of property in the name of the assessee under Registration Act is not determinative of ownership. One needs to give importance to the beneficial ownership instead of legal ownership, as it is the beneficial owner and not the legal owner who shall be eligible for depreciation. This is based on the ruling of the Supreme Court in the case of Mysore Minerals Ltd[8], wherein it was held that if the assessee has taken the possession of the property in pursuance of an agreement to sell, then the assessee shall deemed to be the owner of the property for claiming depreciation even if the property is not registered in his name. Similar view has been taken by several other high courts that the title is received on possession and registration is a mere formality.

5. Taxability of immovable property of a discontinued business on which depreciation was claimed earlier

- Section 41 of the Act is a deeming fiction that brings any recovery of loss, expenditure, remission or cessation of any trading liability, bad debts allowed as deduction earlier chargeable to tax under the head income from business or profession. The same concept applies to a business asset on which depreciation was claimed earlier, is sold after the cessation of the business.

- Any business asset on which depreciation has been claimed by the assessee, the gains arising on transfer of such assets shall be taxable us short term capital gains/loss in accordance with section 50 of the Act.

- It was held by ITAT Mumbai Bench in the various cases[9] that it is not mandatory that the assets must be used during the year of business for attracting provisions of section 50 of the Act. Even if the business asset on which depreciation was claimed is transferred after the termination of business the gains/loss arising thereof shall still be taxable under section 50 of the Act as capital gains from short term capital assets.

- It will be interesting to note that this will hold true even if depreciation on such asset was claimed only for one year and thereafter for next 20 years no depreciation was claimed as the asset was not used for business purpose.

6. Capital Gains on transfer of a depreciable business asset

- As per the provisions of section 50 of the Act, any gain/loss arising on the transfer of any capital asset which formed a part of block of assets and in respect of which depreciation has been claimed shall

8. *Mysore Mills Ltd. vs. CIT [1996] 106 Taxmann 166 (SC)*

9. *Chhabria Trust vs. Assistant CIT [2003] 87 IDT 181 (Mumbai)*
Oceanic Investment Ltd. vs. Assistant CIT [1997] 57 TTJ 549 (Mumbai)
Shree Changdeo Sugar Mills Ltd. vs. Joint CIT [2011] 44 SOT 49 (Mumbai)

deemed to be the capital gains arising from transfer of short term capital assets.

- From perusal of section 50 of the Act, it is apparent that it contains a special provision for 'computing capital gains' in case of depreciable assets. Further, section 50 of the Act is a deeming provision and only by legal fiction, income from transfer of long term capital assets (held for a period of more than 36 months (24 months for immovable property)) is treated as capital gains arising from transfer of short term capital assets which otherwise would be long term capital gains.

- Once the amount of capital gains/loss is determined in case of depreciable asset as per section 50 of the Act, ignoring the mandate of sections 48 and section 49 of the Act which otherwise deals with the mode of computation of capital gains the function of the provisions of section 50 of the Act shall come to an end and the capital gains so determined shall be dealt with the general provisions of the Act.

- For the purpose of determining capital gains under section 50 of the Act the provisions of section 48 and section 49 of the Act shall be applicable subject to some modifications. The cost of the asset transferred shall be determined as per section 50A of the Act.

- Section 50A of the Act specifies that the WDV as defined under section 43(6) of the Act at the beginning of the year of transfer shall be the cost of acquisition of the asset. In a situation where the asset is sold after number of years of termination of business or profession, the WDV as on the last day of the year when the business or profession was in continuance can be considered as the cost of acquisition for such depreciable asset. The difference between the Net Value of Consideration and the Cost of acquisition as determined under section 50A of the Act shall deemed to be Capital Gains arising from the transfer of short term capital assets.

- A question may arise for cost of acquisition of the asset received in inheritance, where the asset inherited was formerly used by the previous owner for the purpose of his business or profession wherein he claimed depreciation. Generally, as per the provisions of section 49(1) of the Act, where any asset is received in inheritance, the cost to the previous owner shall deemed to the cost of acquisition for the new owner. As per section 50A of the Act, the cost of the asset to the assesse (i.e. previous owner), who has claimed depreciation, shall be the WDV. Accordingly when a person receives such assets by modes prescribed in the section 49(1) (e.g. gift, inheritance etc.) of the Act, then the cost of acquisition for such new owner shall also be WDV as per section 50A of the Act. However interestingly one can argue that the provisions of section 50A are applicable only to the assessee who has claimed depreciation and not to the new owner and as per section 49(1) of the Act, the deemed cost is "the cost for which the previous owner of the property has acquired it" and hence the cost available to him shall be the original cost of acquisition of the previous owner. Another interesting question will be whether the indexation benefit shall be available from the date of acquisition of the asset by previous owner or date of receipt of asset by the new owner. The Bombay High Court in the case of Manjula J. Shah[10] held that, in case of transfer of

10. *CIT vs. Manjulal J. Shah [2011] 16 taxmann.com 42 (Bombay)*

capital asset acquired by way of gift or will, the indexation shall be allowed date of acquisition of the previous owner.

6a. Further clarifications in reference to various decisions

- It is a well settled law that the provisions of section 50 of the Act are only applicable up to the stage of computation of capital gains in case of depreciable assets. Once the capital gains/loss is computed on depreciable assets as per the section 50 of the Act, the operation of such section ceases and hence an assessee having gains/loss from such depreciable assets which otherwise are long-term assets based on its period of holding shall be governed by the regular provisions of the Act and shall also be eligible for benefits and exemptions that are usually available for long term capital gains/loss.

- In the backdrop of above discussion, it was held by the Bombay High Court in the case of Pursarth Trading Co. (P.) Ltd.[11] and Parrys (Eastern) (P.) Ltd.[12] that the capital gains arising from transfer of depreciable assets are chargeable to tax under section 50 of the Act. However, where such assets are held by the assessee for a period of more than 36 months (24 months in case of immovable property) i.e. where such depreciable assets are long term in nature, the nature of the gain arising on transfer of such assets sustains and subsequently such gains shall qualify for set off against the brought forward loss from the long-term capital assets. Even though no long term capital gains enters into the computation of total income of assessee on this transaction, the assessee shall be entitled to such set offs in terms of section 74 of the Act.

- The ITAT Mumbai bench in the case of Smita Conductors Ltd[13]. held that for the purpose of computation of capital gains, the asset has to be treated as short term capital asset but for applicability of tax rate the asset has to be treated as long term capital asset if it was held for more than 36 months (24 months in case of immovable property) and the gain so realised shall retain its character of being long term capital gain for all other provisions of the Act. Consequently, gains arising from transfer of such depreciable assets shall be taxable at the rates specified in section 112 of the Act if the asset qualifies to be a long term asset as per section 2(42A) of the Act.

- The Bombay High Court in the case of Ace Builders (P.) Ltd.[14] delivered a landmark judgment that exemption under section 54E of the Act shall be allowable against capital gains of depreciable assets which are chargeable to tax as per provisions of section 50 of the Act. It is true that section 50 of the Act is enacted with the object of denying benefits to the owners of depreciable assets. However, this restriction is limited to computation of capital gains and not to exemption provisions. The section 50 of the Act makes it explicitly clear that the deeming fiction created in sub-sections (1) and (2) of section 50 of the Act is restricted only to the mode of computation of capital gains contained in section 48 and section 49 of the Act and cannot be extended beyond that. The section 54E of the Act does not make any

11. *CIT vs. Pursarth Trading Co. (P.) Ltd. [2013] 33 taxmann.com 482 (Bombay)*
12. *CIT vs. Parrys (Eastern) (P.) Ltd. [2016] 66 taxmann.com 330 (Bombay)*
13. *Smita Conductors Ltd. vs. Deputy CIT [2014] 41 taxmann.com 514 (Mumbai – Tribunal)*
14. *CIT vs. Ace Builders (P.) Ltd. [2005] 144 taxmann 855 (Bombay)*

distinction between depreciable assets and non-depreciable assets and hence the exemption available to depreciable asset under section 54E of the Act cannot be denied by referring to the fiction created under section 50 of the Act. Even if the transfer is deemed to be transfer of short term assets, in terms of section 50 of the Act but where the nature of the asset is long term based on its period of holding the assessee shall be eligible to claim the exemption under section 54E of the Act subject to conditions prescribed in section 54E of the Act. Similar view was upheld by Bombay High Court in the case of Cadbury India Ltd.[15] and United Paper Industries[16] that section 50 of the Act does not convert long term capital assets into short term capital assets and capital gains arising from a long term depreciable capital asset even though chargeable to tax under section 50 of the Act are eligible for exemption under section 54EC of the Act on satisfaction of conditions prescribed in section 54EC of the Act and the same cannot be denied merely because it is chargeable to tax as per section 50 of the Act. The above rationale would be equally applicable to the claim of deduction under section 54EE of the Act subject to satisfaction of prescribed conditions in the section.

- The above principle was also upheld by ITAT Mumbai Bench in a very recent case of Hrishikesh D. Pai[17] wherein the assessee was granted exemption under section 54F of the Act against the capital gains arising from transfer property used for commercial purpose on which depreciation was also claimed by the assessee which was taxable under section 50 of the Act.

Conclusion

Regardless of the various challenges faced by the proprietor, sole proprietorship has always been a choice of the masses because of the several benefits and flexibility it offers as compared to other business structures. Since a proprietorship firm is unincorporated entity there are very minimal compliance requirements and it also enjoys some of the deductions of Chapter VI-A of the Act which are generally not available to other entities. The Income Tax Rate for a proprietorship firm is based on individual slab rates and hence initially even the income tax liability could be low as compared to a Partnership Firm, Limited Liability Partnership or Company. Subsequently, over a period of time when the business develops and grows it may be beneficial to have a more organised business structure. Nevertheless, as we all know **"Rome was not built in a day"** and **"Big Things Have Small Beginnings"**, a person passionate about business can always have a start with Sole Proprietorship Concern and later venture into new business structures.

15. *CIT vs. Cadbury India Ltd. [2015] 53 taxmann.com 227 (Bombay)*
16. *CIT vs. United Paper Industries [2014] 42 taxmann.com 79 (Bombay)*
17. *Deputy CIT vs. Hrishikesh D Pai [2018] 98 taxmann.com 305*

DIRECT TAXES

Supreme Court

Keshav B. Bhujle,
Advocate

1 ***GENPACT India Private Ltd. vs. Dy. CIT***

[2019] 419 ITR 440 (SC): dated 22-11-2019

Appeal to Commissioner (Appeals) – Ss. 115QA, 246(1) and 246A(1) of ITA 1961 – Appealable orders – Company – Additional tax on distributed income – Buyback of shares – Appeal from order "where assessee denies his liability to be assessed under this Act" – Expression not restricted to issues arising out of or touching upon assessment u/s. 143 or s. 144 – Determination and computation of liability of assessee to pay additional tax on distributed income on buy-back of shares u/s. 115QA – Covered by expression and appealable: (A.Y. 2014-15)

On 10-9-2013, a scheme of arrangement was approved by the Delhi High Court pursuant to which the assessee company bought back 7,50,000 shares at the rate of ₹ 35,000 per share for a total consideration of ₹ 2,625 crore from its holding company. In its return for the A.Y. 2014-15, it declared the details of the transaction but denied the liability to pay any tax. The Assessing Officer rejected the assessee's contention that the transaction was not a buyback in terms of section 115QA of the Act but pursuant to a scheme approved by the High Court, and held that the assessee was liable to pay tax at the rate of 20 per cent in terms of section 115QA of the Act in respect of distributed income of ₹ 2,625 crore. The assessee filed a writ petition in the Delhi High Court against this portion of the assessment order.

On 25-1-2017 when a preliminary objection was raised by the Department that alternate and efficacious remedy of filing an appeal was available, the High Court took the view that *prima facie*, the non-obstante clause in section 115QA of the Act restricted the nature of the levy to transactions defined by the provision itself, i. e., those covered by section 77A of the Companies Act, 1956, and directed that the demand u/s. 115QA of the Act should not be enforced till the next date of hearing. The matter thereafter came up on 30/08/2017 when the interim order was made absolute. When the matter was taken up after completion of pleadings, the Department submitted that since the remedy of appeal was available to the assessee, the writ petition should not be entertained. The assessee submitted that the demand u/s. 115QA could not be considered as forming part of the assessment order and it must be something separate from the order of assessment. The Court held that the computation of the total taxable income included the demands raised under all heads including the demand u/s. 115QA of the Act and that therefore it was not possible for the Court to read this part of the order separate from the rest of the assessment order. The Court held that it had in fact not earlier expressed any view on the maintainability of the petition, although the matter had been heard on this aspect and that it could not be taken to have impliedly overruled such an objection and decided to hear the petition on the merits. The court refused to entertain the writ petition under article 226 of the Constitution against the demand u/s. 115QA of the Act and granted the assessee an opportunity to file an appeal u/s. 246A of the Act before the Commissioner (Appeals) to challenge the assessment order only in so far as it created a demand u/s. 115QA of the Act within ten days without being affected by the bar of limitation. Within the time limit of 10 days afforded by the High Court, the assessee filed an appeal. The assessee also filed a special leave petition to the Supreme Court.

The Supreme Court dismissed the appeal and held as under:

"i) An appeal is maintainable against the determination of liability u/s. 115QA of the Income-tax Act, 1961. One of the key expressions appearing in section 246(1)(a) and section 246A(1)(a) of the Act is "where the assessee denies his liability to be assessed under this Act". The expression "denies his liability to be assessed" is quite comprehensive and takes within its fold not only total denial of liability but also where the assessee denies his liability to be assessed under particular circumstances under the Act.

ii) Section 115QA of the Act stipulates that in the case of buyback of shares referred to in that section, the company shall be liable to pay additional Income-tax at the rate of 20 per cent on the distributed income. The computation and extent of liability determined under the provisions of section 115QA of the Act would squarely be covered under the expression "where the assessee denies his liability to be assessed under this Act". There is no reason why the scope of the expression should be restricted and confined to issues arising out of or touching upon assessment proceedings either u/s. 143 or section 144 of the Act.

iii) There was no infirmity in the approach adopted by the High Court in refusing to entertain the writ petition. The submission that once the threshold was crossed despite the preliminary objection being raised, the High Court ought not to have considered the issue regarding alternate remedy, may not be correct. The first order dated 25-1-2017 passed by the High Court did record the preliminary objection but was prima facie of the view that the transactions defined in section 115QA were initially confined to those covered by section 77A of the Companies Act. Therefore, without rejecting the preliminary objection, notice was issued in the matter. The subsequent order undoubtedly made the earlier interim order absolute. However, the preliminary objection having not been dealt with and disposed of, the matter was still at large. The concessions given on behalf of the Department as recorded in the directions issued by the High Court also took care of matters of prejudice, if any.

iv) Consequently, the assessee, as a matter of fact, would have a fuller, adequate and efficacious remedy by way of appeal before the appellate authority. The appeal preferred by the assessee shall be proceeded with in accordance with law."

2 ***Purshottam Khatri vs. CIT***

[2019] 419 ITR 475 (SC): dated 9-7-2019

Appeal to High Court – S. 260A of ITA 1961 – Substantial question of law – Income from undisclosed sources – Unexplained deposits in NRE accounts – Tribunal looking into exchange vouchers and finding sums were in fact brought to India by assessee during his visit because dates of vouchers co-related with date of arrival of assessee – Finding of fact – High Court ought not to have disturbed it (A.Ys. 1992-93 to 1997-98)

The assessee, an individual, left India in 1968 and was employed in Muscat and Dubai till the year 1992-93 and returned to India thereafter. The assessee had made several deposits in foreign currency in his non-resident (external) accounts in different banks in India. The Assessing Officer treated deposits of foreign currency in these accounts of the assessee for which no declaration forms were available as unexplained deposits and undisclosed income of the assessee and added interest on such unexplained deposits as part of his income.

The Tribunal accepted the explanation of the assessee that the foreign currency shown in the currency exchange vouchers was in fact brought to India by the assessee during his visit on the ground that the dates of the exchange vouchers co-related with the dates of arrival of the assessee and held that the assessee had brought $9,08,800 besides pounds out of which he has deposited $7,55,534 in his Non-Resident (External) Account, that out of this deposit, the assessee invested $40,575 in fixed deposits and that the balance $1,43,266 was either utilised in India for different purposes or taken back by the assessee while leaving India. The Tribunal therefore deleted the addition made on account of unexplained deposit of dollars.

The Madhya Pradesh High Court held that the exchange vouchers issued by the exchange centres abroad and certificates issued by banks in India representing the income which accrued outside India were without any evidence and that the Tribunal was not justified in deleting the additional amounts equivalent to the foreign exchange covered by the foreign currency exchange vouchers from the income of the assessee, and held that only income by way of interest standing to the credit of a person in a Non-Resident (External) Account of the bank in accordance with the Foreign Exchange Rules and Regulations was exempt from tax.

The Supreme Court allowed the appeal filed by the assessee and held as under:

"i) Basically the High Court had made the additions on the ground that the assessee had been unable to present declaration forms that had been filled in by him at the time of his visits to India from abroad. Keeping in mind the fact that these declaration forms were asked for long after the expenditure had, in fact, been incurred, it could not possibly be said that the Appellate Tribunal's judgment and findings therein were perverse, which was the only entry on facts for the High Court exercising its appellate jurisdiction u/s. 260A of the Income-tax Act, 1961.

ii) The High Court ought not to have interfered with the Appellate Tribunal's judgment as no substantial question of law arose therefrom.

iii) Accordingly, we allow the appeal and set aside the judgment of the High Court and reinstate that of the Appellate Tribunal."

3 ***Senior Bhosale Estate (HUF) vs. ACIT;*** *(2019) 419 ITR 732 (SC): dated 7-11-2019*

Appeal to High Court – S. 260A of ITA 1961 – Condonation of delay – Assessees contending they had no knowledge of order of tribunal till auction notice issued – Contention on affidavit not refuted by Department – No question of not believing it – Delay to be condoned and appeals to be heard

Applications filed by the assessee for condonation of the delay of 1,754 days in filing the appeals before the High Court against the common order dated December 29, 2003 passed by the Appellate Tribunal stating that they had no knowledge about passing of order dated December 29, 2003, until they were confronted with the auction notices in June, 2008 issued by the competent authority, were dismissed by the Bombay High Court.

The Supreme Court allowed the appeal filed by the assessee and held as under:

"i) Soon after coming to know of the passing of the orders by the Appellate Tribunal, the assessees had filed appeals on 19-7-2008 accompanied by applications for condonation of the delay. The Department did not expressly refute the stand taken by the assessees, that they had no knowledge about the passing of the order dated 29-12-2003 until June, 2008.

ii) Unless that fact was refuted, the question of disbelieving the stand taken by the assessees on affidavit, could not arise. The High Court should have shown indulgence to the assessees by condoning the delay in filing the appeals.

iii) The orders of the High Court were liable to be set aside and the appeals stand restored to the file of the High Court for disposal in accordance with law."

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DIRECT TAXES

High Court

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

1 ***Ananda Marga Pracaraka Sangha & Anr. vs. UOI,***

Writ Petition No. 17205 (W) of 2019, Hon'ble Calcutta High Court, Order dt. 27th November, 2019

Dispute between the members of society - Misuse of PAN – Returns filed of the society by rival groups - Income Tax Act does not allow both groups to file income tax returns having the same PAN – AO directed to pass a reasoned order

A peculiar situation had arisen in the writ petition filed before Hon'ble High Court. The petitioners claimed that they were the sole authorised persons carrying on the management of society. They stated that they have been filing income tax returns since the inception of the society. In the past few years, it had come to light that the other rival group had filed a revised income tax returns with respect to the returns filed by the petitioners for the society. It was submitted that the rival group has been using the same Permanent Account Number (PAN) and hacking into the user name of the society. On the contrary, the rival group contended that they have been filing the income tax returns since inception and it is the petitioners that have carried out hacking of username and password hacking. According to them, several complaints have been filed before the Income-tax authorities and the issue is known to the Income-tax authorities with regard to the two returns being filed by both these groups. The Income-tax authorities handed over a report prepared by the Joint Director of the Income-tax (Headquarters) (Technical). The report stated that the Assessing Officer may be asked to decide which party has the actual authority. The Court observed that there was long-running dispute between the petitioner and the rival group and both these groups are filing annual returns before the Registrar of Societies. It was noted that there is no provision under the Income-tax Act, 1961 that allows both these groups to file income tax returns for a particular financial year having the same Permanent Account Number. Under the Income-tax Act, 1961 only one Permanent Account Number is issued to an entity and only one return can be filed. The Court held that the factual aspect with regard to which group has been issued the original PAN has to be ascertained by the Income-tax authorities. Furthermore, the Income-tax authorities may reject the returns that have been filed by the group that is not authorised to do so. In light of the above, the Court directed the Assessing Officer to grant an opportunity of hearing to the petitioner and the rival group, and thereafter, pass a reasoned order within a time-bound period. It was made clear that the Assessing Officer shall examine the issue as to which group is authorised to file the return as per the PAN that has been issued by the Income-tax authorities. The parties shall be at liberty to produce all documents with regard to the title suits that indicate as to who is controlling the management of the society. Upon passing of the order, the Assessing Officer shall cancel the PAN card issued to the unauthorised/ wrong party and reject the return filed by them. The Court further directed that a reasoned order should be communicated to both the parties and these proceedings be completed within a period of eight weeks..

2 ***CIT vs. M/s. Seven Seas Distillery (Pvt.) Ltd.***

Tax Case (Appeal) No. 2025 of 2008, Hon'ble Madras High Court, Order dt. 3rd December, 2019

Disallowance u/s. 40(a) – Payment made to a party residing outside India towards interest, etc., without deduction of tax – No tax required to be deducted in specific exemption from Ministry of Finance – [AY 2000-01]

The assessee company had made an interest payment of ₹ 73,91,128/- on the foreign currency loan taken from M/s. London Forfaiting Asia Ltd. No tax was deducted u/s. 195 of the I.T. Act. The assessee alleged that the Department of Economic Affairs, Ministry of Finance, Govt. of India, *vide* their letter No. F.No.4(32)/97-ECB dated 23.9.1997, had specifically exempted the assessee from withholding tax on the payment of interest and administrative charges against the loan payment from M/s. London Forfaiting Asia Ltd. Hence, assessee was not required to deduct any tax under sec. 195 and, therefore, the provisions of sec. 40(a) cannot be attracted. The Assessing Officer held that the loan proceeds were used for repayment of loan from Raghava Enterprises P. Ltd. because the assessee had explained this by showing that initially, the assessee had borrowed loan for working capital requirement from Raghava Enterprises P. Ltd., and once foreign currency loan was available then the loan from Raghava Enterprises P. Ltd. was repaid. Hence the Assessing Officer disallowed u/s. 40(a) for non-deduction of tax u/s. 195. Before the Court, the Department submitted that the provisions of Section 10(15)(f) of the Act provide that such interest payment on the foreign currency loans will be exempted, only if the loan is employed for industrial development in India. But, since in the present case, the loan taken by the assessee from M/s. London Forfaiting Asia Ltd. in foreign currency was utilised by it for repayment of another loan from one M/s. Raghava Enterprises P. Limited and the same loan was not directly employed for the industrial development by the assessee, therefore, the recipients of the said interest viz., M/s. London Forfaiting Asia Ltd. cannot claim any exemption on such interest payment under Section 10(15)(f) of the Act and consequently, the assessee was liable to deduct tax at source and in the absence of the same, the interest payment was liable to be added back to its declared income under Section 40(a) of the Act. The Court referred to the exemption given by the Ministry of Finance in favour of the assessee vide letter dated 23.09.1997 and was of the view that section 40(a) could not attract to the assessee. The Court further observed that even though the foreign currency loan in question was utilised by the assessee to repay the loan of one M/s. Raghava Enterprises P. Limited, which was admittedly taken from M/s. Raghava Enterprises P. Limited towards its working capital requirement, the purpose of Section 10(15)(f) of the Act, for the industrial development stood satisfied in the present case. The words in the said provision quoted above are not "for industrial development", but the words "having regard to the need for industrial development in India", which are wider in nature. These words employed in Section 10(15)(f) of the Act are wide enough to cover within its ambit and scope even the indirect utilisation of the funds for industrial development in India. Therefore, even if the loan taken as a working capital loan from M/s. Raghava Enterprises P. Limited earlier and employed by the assessee for such industrial development and the foreign currency loan in question was utilised to repay the loan to M/s. Raghava Enterprises P. Limited, the exemption given by the Ministry of Finance in favour of the assessee cannot be said to have been lost by such facts. It was not the case of the Revenue, that the exemption given to the assessee stood revoked or withdrawn on any such contingency at any point in time. The Court thus dismissed the departmental appeal.

3 ***Curewel (India) Ltd. vs. ITO, Income Tax***

Appeal No. 259 of 2018, Hon'ble Delhi High Court, Order dt. 28th November 2019

Assessment post remand – Additional claim raised in remand proceedings - Remand made by Tribunal was a complete and wholesale remand for framing a fresh assessment – Additional claim could be allowed – [AY 2002-03]

The Assessing Officer had passed the assessment order for AY 2002-03 u/s. 144 on 30.03.2005. Eventually, on 07.01.2009, the Tribunal set aside the matter to the file of the Assessing Officer to adjudicate afresh after considering the documents and submissions of the assessee. The Assessing Officer then passed a fresh assessment order on 01.12.2009 u/s. 143(3) r.w.s. 254 of the Act, making certain additions and disallowances. The said order was upheld by the CIT (A) on 20.10.2010. On further appeal, once again, the Tribunal *vide* order dated 10.03.2011, set aside the matter to the file of the Assessing Officer with a direction to framing a fresh assessment. Thereafter, the Assessing Officer deleted the additions and the disallowances made in the first two rounds. The assessee had made a fresh claim regarding non-taxability of income arising from the write-off of liability by Canara Bank in its favour amounting to ₹ 1,36,45,525/- which had earlier been offered to tax as income. The Assessing Officer without examining the said claim of the assessee, rejected the same at the threshold, on the ground that in remand proceedings, the assessee could not raise a fresh claim. The appeal preferred by the assessee before the CIT(A) was rejected. On further appeal, the Tribunal decided against the assessee on the issue of the additional claim raised. Before the High Court, it was submitted that the Tribunal, in its order of remand dated 10.03.2011, had completely set aside the assessment order on a fundamental premise, namely, on finding the approach of the lower authorities - which included the Assessing Officer, to be highly unjustified and regrettable. The Tribunal had found the assessment to be excessive, harsh and arbitrary. The assessment order and the first appellate order were set aside and restored to the file of the Assessing Officer to frame the same afresh. The Tribunal permitted the assessee to produce its books of account before the Assessing Officer and was required to be granted an opportunity for that purpose. Since the original assessment had been framed on best judgment basis, and the assessee claimed that its books of account were available for the relevant assessment year, the Tribunal held that in the eventuality, the best judgment assessment is inevitable, then fair and reasonable approach, as warranted by law, has to be adopted by lower authorities and that the Assessing Officer should keep the same in mind while reframing the assessment. It was further submitted that, in fact, the Assessing Officer had also made fresh additions while passing the fresh assessment order, precisely on the same basis that a fresh assessment was being framed. Else, the Assessing Officer could not have made fresh additions of ₹ 40,045/- towards the late deposit of employees' contribution towards PF and ESI, and could not have disallowed set-off of the brought forward losses to the extent of ₹ 2,14,35,459/. The Court held that it was clear that the remand made by the Tribunal to the Assessing Officer *vide* order dated 10.03.2011 was a complete and wholesale remand for framing a fresh assessment. The remand was not limited in its scope and was occasioned upon the Tribunal finding the approach of the Assessing Officer and the CIT (A) to be excessive, harsh and arbitrary. That being the position, the Assessing Officer ought to have evaluated the claim made by the assessee for the write-off of liability by Canara Bank in its favour amounting to ₹ 1,36,45,525/-, and should not have rejected the same merely on the ground of it being raised for the first time. The observations of the Tribunal in the impugned order were erroneous since the Tribunal has not appreciated the scope and nature of the remand ordered by it by its earlier order dated 10.03.2011. The Court thus allowed to raise the claim and restored the matter back to the Assessing Officer for evaluation of the said claim on its own merits.

4 ***Selvel Transit Advertising Pvt. Ltd. vs. CIT***

Writ Petition No. 1054 of 2011, Hon'ble Calcutta High Court, Order dt. 4th December 2019

Reopening u/s. 148 – Assessee claiming deduction u/s. 80IA since AY 2001-02 – reopening on the basis of subsequent assessment for AY 2008-09 wherein deduction u/s. 80IA was not allowed – no tangible material having a live link with the formation of the belief – reopening quashed - [AY 2006-07]

The assessee was engaged, inter alia, in infrastructure projects and entitled to avail exemption under section 80-IA. Such exemptions were allowed in the previous assessment years 2001-02 to 2007-08. However it was disallowed in AY 2008-09 and hence notice dated 24th March, 2011 was issued u/s. 148, to reassess the income for Assessment Year 2006-07. The reasons for reopening mentioned that, during the course of assessment proceedings for A.Y. 2008-09, a letter dated 25.10.2010 was filed by the assessee stating that assessee was engaged in the business of outdoor advertising and to develop, operate and maintain Infrastructural Facility (Bridge) and acopy of agreement with Executive Engineer, P.W. (Roads) Department, was also furnished. According to the said agreement, the assessee was required to build and maintain two overbridges on Nazrul Islam Avenue, and both the Bridges would remain the property of the assessee for twenty years. However, the Balance Sheet did not disclose any such assets. During assessment proceedings of AY 2008-09, it was submitted that it had treated such expenditure as Deferred Revenue expenditure. The reasons further stated that during assessment proceedings of AY 2008-09, though the AO repeatedly asked for copies of Bills & Vouchers towards the construction of the Bridges, the assessee never produced any evidences. Thus the construction of Bridges by the assessee remained unverified with documentary evidence. No confirmatory certificates were received from the Executive Engineer, P.W.D. (Roads) Division, in response to notice u/s. 133(6) dated 27.10.2010. Furthermore, a reply from Executive Engineer, P.W.D.(Roads) Department was received by the AO on 14.1.2011, which is much after completion of the time-barring assessment. Firstly, such a reply was received in this office 2 months after the date of issue. Secondly, the name of the Executive Engineer and his official seal did not appear in the letter. Thirdly, the letter was completely silent about the overbridge at Kaikhali crossing. The reasons thus mentioned that genuineness of such a letter needs to be verified.

The assessee filed a writ petition before the High Court challenging the reopening. It was submitted that

a) for the first time for the assessment year 2008-09, the Assessing Officer did not allow the deduction under Section 80-IA of the Act on the ground that from the Balance Sheet it shows that no fixed asset has been disclosed in the audited Balance Sheet though under the agreement the assessee becomes the owner of the two overpasses i.e., overbridges for 20 years. An appeal against the said order was filed before the CIT (Appeals). The CIT (Appeals) noticed the fact that the assessee had been allowed deduction under Section 80-IA of the Act from the very inception i.e., 2001-02 to 2007-08 even though in the Balance Sheet asset was shown to be nil after the assessment year 2007-08 in view of the accounting system which was followed by the assessee. The CIT (Appeals) allowed the deduction under Section 80-IA for the assessment year 2008-09 in view of the fact that when the assessee had been allowed the benefit under Section 80-IA of the Act it is eligible for such benefit for 10 consecutive years.

b) For the Assessment Year 2006-07, the assessment was initially made u/s. 143(3) on 14 July, 2008. In the circumstances, an attempt to reopen was on change of opinion. Reliance was placed on a judgment of the Supreme Court in ***CIT vs. Kelvinator of India Ltd. reported in (2010) 320 ITR 561.***

c) There was no tangible material disclosed in the reasons to believe, let alone any link with formation of the belief.

To the contrary the department submitted that,

a) Bills and vouchers towards construction of the bridges were not produced by assessee. Assessee's claim of having constructed, remains unverified.

b) During assessment proceeding for AY 2008-09, no confirmatory certificate was received from Executive Engineer, PWD (Roads) Division, in response to notice dated 7th October, 2010 under section 133(6). Basis this, the Assessing Officer found that assessee had failed to fully disclose truly, all material facts necessary for assessment and hence the Assessing Officer got jurisdiction to reopen and reassess.

c) In the previous years where the assessment was done u/s. 143(3) from the Assessment Year 2003-04 to Assessment Year 2007-08, a question was never raised about the eligibility criteria of deduction under Section 80-IA of the Income-tax Act, 1961 by the then Assessing Officers. The assessee's allegation is incorrect that the Assessing Officer had no new or fresh information for reopening of the same. The Assessing Officer reopened the case as soon as he came to know about the new information that the assessee company was not in the business of the infrastructural facility but in the business of out-door advertisement and not fulfilling the criteria for deduction under Section 80IA of the Income Tax Act, 1961.

After going through the facts and law, the Court observed that nothing had been disclosed by Revenue to give credence to the statement in the reasons to believe that in spite of repeatedly asking for copies of bills and vouchers towards construction of the bridges, assessee never produced any evidence, in the face of contents of said two notices issued under sections 142(1) and 143(2). Court observed that the assertion in the affidavit-in-opposition that the Assessing Officer for the first time came to know that assessee was not in the business of infrastructural facility but in the business of outdoor advertisement, thereby not fulfilling criteria for deduction under section 80-IA, was not based on any tangible material that has been placed before Court, either by the reasons or by subsequent disclosure. There is no disclosure in the affidavit-in-opposition. Letter of Executive Engineer, PWD (Roads) Department received on 14th January, 2011 was correspondence post-assessment order dated 14th July, 2008, in scrutiny assessment made u/s. 143(3). The notice dated 27th October, 2010 issued u/s. 133(6), according to the Assessing Officer, drew a belated response from Executive Engineer PWD (Roads) Department and not relied upon in the reasons, for being of doubtful genuineness. Absence of reliable answer from such as appears to be given by a government functionary, being notice u/s. 133(6), can be cause for further inquiry but not tangible material having a live link with the formation of the belief. The Court held that the letter obviously does not support the contention of Revenue. As such no material had been disclosed by Revenue. The Court held that all these lead to an inevitable conclusion that there has been a change of opinion. The Court allowed the writ petition. Impugned notice was set aside and the Court quashed all proceedings taken pursuant thereto.

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DIRECT TAXES

Tribunal

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

Unreported Decisions

1 ***ACIT (E) vs. Indraprastha Cancer Society & Research Center***

[ITA 641/Del/2017] (Assessment Year: 2012-13), Order dated 23-12-2019

Section 11 – while computing the income on commercial principles under section 11, the assessee is entitled to make a claim of depreciation, provision for doubtful debt and loss on sale of fixed assets

Facts

The assessee is a Society, registered u/s. 12A of the Act since 01.04.2007. The assessee has been granted an exemption u/s. 10(23)(via) and also notified u/s. 35(1)(ii) of the Act. The assessee is running a hospital in the name of Rajiv Gandhi Cancer Institute & Research Centre in Delhi. The activities carried out by the assessee are covered within the meaning of "Charitable activities" as defined u/s. 2(15) of the Act. During the course of assessment proceedings, the AO observed that the assessee has claimed depreciation of ₹ 10.62 crore on total application of income of ₹ 1,43,10,87,160/-. The AO opined that the benefit of application of fund has already been claimed when the fixed asset was acquired. Thus, the allowance of depreciation would amount to double deduction. The AO therefore, disallowed the depreciation claimed on fixed asset. Further, the AO observed that the assessee has claimed provision for doubtful debts of ₹ 0.11 lakh and bad debts actually written off of ₹ 9.91 Lacs. The AO was of the opinion that the provisions of sections 28 to 44 which are related to computation of business income are not applicable in the case of charitable organisations. Thus, the AO disallowed the provision of doubtful debt of ₹ 20.11 lakh and bad debt of ₹ 9.91 lakh. Further, the AO noticed that the assessee has claimed loss on sale of fixed assets of ₹ 20.40 lakh. With respect to the same, the AO opined that the provisions of sec. 45 to 55 which are related to the capital gains are not applicable to charitable activities. Accordingly, the AO disallowed the claim of loss of ₹ 20.40 Lacs. On appeal, the CIT(A) allowed all the said claims of the assessee following the order of his predecessor in the A.Y. 2006-07. Being aggrieved, the Revenue preferred an appeal before the ITAT. After hearing the submissions of both the parties, the ITAT held as under:

Held

The ITAT while deciding the issue of allowability of depreciation of fixed asset relied on the decision of its Co-ordinate Bench in assessee's own case for the A.Y. 2010-11 [ITA 2555/Del/2015] and held that sub-section (6) of section 11 of the Act debarred the assessee from claiming depreciation while computing the income u/s. 11 of the Act. The said provision has been introduced under the Act with effect from 1st April, 2015. The assessment year involved in the present case is A.Y. 2012-13. Thus, it will not apply in the facts under consideration. Further, while dealing with the second issue of allowability of the provision of doubtful debts and bad debts, the ITAT relied on the decision of Co-ordinate Bench in Assessee's own case and observed that the income of the trust available for application to charitable purposes in India should be computed in accordance with commercial principles and not in accordance with the strict provisions of the Act. The ITAT therefore, held that while computing the income available to the trust for application for charitable purpose in India in accordance with sec. 11(1)(a), the provision for doubtful debts should be deducted. Further, with respect to the third issue of disallowance of loss on sale of fixed asset, the ITAT observed that there is no bar in claiming loss on sale of fixed asset while computing income u/s. 11 of the Act. The CIT(A) was correct in observing that the assessee could demonstrate that the income u/s. 11 has to be determined on commercial principles.

2 ***Sri Purna Chandra Biswal vs. PCIT***

[ITA 200 / Ctk / 2018] (Assessment Year: 2013-14), Order dated 15.11.2019

Revision – Section 263 of the Act – When the AO while passing the assessment order rejected the books of account u/s. 145(3) and estimated the gross profit of the assessee then, the Pr. CIT cannot invoke the revisionary jurisdiction u/s. 263 and direct the AO to make addition u/s. 68 or 41 after accepting the returned income of the assessee

Facts

The Assessee is engaged in the business of civil contracts and hiring of machinery. The Assessee filed a return of income for the relevant Assessment Year on 30.10.2013 declaring total income at ₹ 28,90,580/-. The said return was selected for scrutiny assessment by issuing the statutory notices u/s. 143(2) and 142(1) of the Act. In response to the said notices, the assessee filed audit report u/s. 44AB in Forms 3CB and 3CD along with audited balance sheet and Profit & Loss Account for the previous year. The assessee also produced expenses ledger, bill register, bank accounts in support of the accounts filed with the audit report. However, the assessee could not produce cash book. The AO while passing the assessment order rejected the books of account of the assessee u/s. 145(3) of the Act and determined the total income at ₹ 28,97,770/-. Subsequently, the Pr. CIT invoked the provisions of s. 263 of the Act and directed the AO to make fresh assessment as according to him the assessment order lacked detailed enquiry and the same was erroneous and prejudicial to the interests of the revenue. In the show cause notice issued u/s. 263 of the Act, the Pr. CIT directed the AO to decide chargeability of a sum of ₹ 2,69,16,055/-

u/s. 41 or section 68 allegedly representing unexplained cash credit in the form of sundry creditors. Being aggrieved by the said order, the Assessee preferred an appeal before the ITAT. After hearing both the parties, the ITAT held as under:

Held

The ITAT held that from the assessment order, it is clear that the AO has rejected the books of account of the assessee and estimated the gross profit. It means that the returned income of the assessee has not been accepted by the AO. After perusing the assessment order and the order passed u/s. 263, the ITAT held that when the return of income has not been accepted and the AO rejected the books of accounts and completed the assessment by estimating the gross profit of the assessee then, again directing the AO to accept the returned income declared by the assessee and examine the chargeability of the sundry creditors in light of the provisions of sec 68 or 41(1) of the Act by invoking the revisionary powers conferred u/s. 263 of the Act is not sustainable under law. The ITAT observed that the Pr. CIT is not justified in setting aside the assessment order and substituting his opinion u/s. 263 against the view taken by the AO. It further, held that on the one hand, the Pr. CIT records that the assessment order is erroneous and prejudicial to the interest of the revenue and on the other hand, the Pr. CIT directed the AO to accept the retuned income of the assessee. If the assessee did not provide the complete details as per the requirement of the notice u/s. 142(1), the AO had opportunity/right to issue the notice u/ss. 131, 133(6) & 133A to the creditors in order to verify the sundry creditors. However, the AO has not done the same. The ITAT held that if the gross profit is estimated by the AO then there is no further question for making addition on the basis of sundry creditors. In the present case the gross profit has been estimated by the AO after considering all the details produced by the assessee. The Pr. CIT is himself confused in directing the AO to make addition u/s. 68 or 41(1). The ITAT further, held that it cannot be said that the view taken by the AO is not a possible view. The ITAT further relying on the decision of the Delhi high Court in the case of ***CIT vs. International Travel House Limited [2012] 344 ITR 554 (Delhi)*** observed that it is now settled law that if while making the assessment, once the AO has completed the assessment rejecting the books of account and estimated the gross profit of the Assessee, again directing the AO to accept the returned income and books of account by invoking the powers conferred u/s. 263, amounts to change of opinion which is not permissible under law. Thus, the ITAT quashed the order of Pr. CIT passed u/s. 263 of the Act and allowed the appeal of the assessee.

Reported Decisions

3 ***NIIT Ltd. vs. DCIT***

(ITA Nos. 376/Del/2014) [2019] 112 taxmann.com 66 (Delhi-Trib.) (Assessment Year 2009-10) order dated 1-11-2019

Section 37(1): Infrastructure assets - taken on finance lease - after the termination of lease if the assessee would buy the same, payments made during lease period would not fall under capital expenditure as the assets are used exclusively for business during lease period, and therefore the said payments are allowable as revenue expenditure.

Facts

The assessee was engaged in the business of information technology education and knowledge solutions. The assessee in the course of its business had taken infrastructure/movable assets on finance lease. During the course of the assessment proceedings, the AO noticed that assessee had claimed a deduction in respect of the payment of principal amount pertaining to the finance lease as revenue expenditure. The AO was of the view that though the interest on such finance lease is allowable as revenue expenditure, payment of principal amount cannot be allowed as revenue expenditure as it is capital in nature. Thus, the AO disallowed the said claim. Being aggrieved, the assessee preferred an appeal before CIT(A) but did not succeed. Thereafter, an appeal was preferred before the ITAT. After hearing both the sides, the ITAT held as under:

Held

The ITAT observed that it is not in dispute that the assessee had entered into the lease agreements time-to-time with different parties and provisions have been made for infrastructure facilities. From a perusal of the said agreements, the ITAT observed that the relevant agreements contained a clause that after termination, the assessee would buy the infrastructure. The infrastructure taken on lease is required for the purpose of business of the assessee. The assessee paid finance lease rentals to the lessor for the purpose of business only. Thus, the assessee is not the owner of the infrastructure facilities provided on rent. The ITAT observed that the identical issue was allowed in favour of the assessee in its own case for previous assessment years. The ITAT held that it is well settled law that the rule of consistency does apply to income-tax proceedings. Therefore, the AO should not have taken out a different view in the assessment year under appeal, when a similar claim of the assessee was already allowed as revenue expenditure in earlier years. The ITAT noted that it is also well settled law that the liability under the Act is governed by the provisions of the Act and is not dependent on the treatment followed for the same in the books of account. It is also well settled that the assessee's claim of a particular deduction is allowable or not, would depend upon the provisions of law relating thereto, and not on the view, which the assessee might take of his right, nor could the existence or absence of entries in the books of account be decisive or conclusive in the matter. The ITAT accepted the contention of the assessee and allowed the appeal.

4 ***ACIT vs. JSW Steel Ltd.***

[ITA No. 159/BAN/2011 & CO No: 59 (Mum) of 2012] [2019] 112 taxmann.com 55 (Mumbai-Trib.) (Assessment Year 2006-07), order dated 29-11-2019

Section 115JB – Sales tax subsidy received by the assessee being a capital receipt does not fall within the definition of income u/s. 2(24) of the Act and thus, when, a receipt is not in the nature of income, it cannot form part of book profit u/s. 115JB

Facts

During the relevant year, the assessee had received a sales tax subsidy of ₹ 36,15,49,828/- from the Government of Karnataka for setting up a new industrial unit in the backward area of the State and it was treated as a capital receipt not chargeable to tax. However, the same was routed through the profit and loss account and was considered as part of the book profits u/s. 115JB of the I.T. Act, 1961. During the course of the assessment proceedings, the AO taxed the same as a revenue receipt against which the assessee preferred an appeal before the CIT(A) and succeeded. Being aggrieved, the Revenue filed an appeal before the ITAT and contended that the said sales tax subsidy is a revenue receipt and thus, must be brought to tax under the normal provisions. As the CIT(A) determined the said subsidy as a capital receipt not chargeable to tax, the assessee on realisation filed a cross objection with an application seeking condonation of delay and contended that the said subsidy being a capital receipt do not fall within the definition of income u/s. 2(24) of the Act and thus, must be excluded even for the purpose of computing book profits u/s. 115JB of the Act. The assessee relied on the various judgments for the said proposition. On the other hand, the DR submitted before the ITAT that the book profit as referred u/s. 115JB shall be computed irrespective of the fact that whether particular receipt is taxable under the Income-tax Act or not. To buttress his contention, He, strongly relied on the decision of the Supreme Court in the case of ***Apollo Tyres Ltd. vs. CIT [2002] 255 ITR 273 (SC).*** After considering both the sides, the ITAT held as under:

Held

The ITAT observed that the Co-ordinate Bench of ITAT, Mumbai in assessee's own case for AY 2004-05 in ITA.No.923/Bang/2009, had considered an identical issue and held that where a receipt is held to be capital in nature not chargeable to tax under the normal provision of the Act, the same cannot be taxed u/s. 115JB of the I.T. Act, 1961. The ITAT further referred to the judgment of the Calcutta High Court, in the case of Ankit Metal & Power Ltd. In ITA No. 155 of 2018 and observed that the said appeal contained an identical issue in which after considering the decision of the Supreme Court in the case of ***Apollo Tyres Ltd. vs. CIT (supra),*** the High Court held that when a receipt is not in the character of income as defined under section 2(24) of the I.T. Act, 1961, then it cannot form part of the book profit u/s. 115JB of the I.T. Act, 1961. It was duly observed by the ITAT that the High Court while allowing the issue in favour of the assessee held that the facts of case before the Supreme Court in the case of Apollo Tyres Limited were altogether different where the income in question was taxable, but was exempt under a specific provision of the Act, and as such it was to be included as a part of book profit, but where the receipt is not in the nature of income at all, it cannot be included in book profit for the purpose of computation u/s. 115JB of the Act. The ITAT further referred to various cases cited by the AR and distinguished those cited by the DR and ultimately held in favour of the assessee and allowed its cross objection.

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Climbing to the top demands strength, whether it is to the top of Mount Everest or to the top of your career.

– A. P. J. Abdul Kalam

INTERNATIONAL TAXATION

Case Law Update

CA Tarunkumar Singhal & Dr. Sunil Moti Lala

A. HIGH COURT

1 ***Pr. Commissioner of Income Tax, Delhi vs. Maruti Suzuki India Ltd.***

[TS-778-HC-2019 (DEL)], WP (C) 13241/2019

The High Court dismissed Revenue's writ challenging the Tribunal's additional ground admission on DTAA rate applicability for DDT

Facts

i. Assessee raised an additional ground praying for restricting the levy of dividend Distribution Tax [DDT] to the beneficial rate of 10% as per DTAA, instead of 16.6% charged in terms of Sec. 115-O of the Income-tax Act.

ii. The Tribunal passed an interim order admitting the additional ground.

iii. Revenue preferred a writ petition challenging the Tribunal's interim order.

iv. Revenue contended that the said interim order was passed without jurisdiction as (1) the additional ground admitted was never raised before the AO and (2) the additional ground could not have been raised by the assessee as it was a resident Indian company and not the recipient of the dividend declared.

v. Revenue additionally contended that the written submissions filed by it were not considered by the Tribunal while passing the interim order.

Decision

i. The High Court held that the impugned order was an interlocutory order passed by the Tribunal in the course of the proceedings. It was not an order determining any rights of the parties on merits. All that the Tribunal had done was to permit the assessee to raise the additional ground.

ii. The Court clarified that the Revenue would have the right to assail the interlocutory order admitting the additional ground as well as the finding that the Tribunal may return on the said additional ground, in case it was aggrieved by the final order that the Tribunal may pass in the pending appeal while preferring an appeal under section 268 of the Income-tax Act.

iii. Additionally, the Court directed the Tribunal to advert to the written submissions filed by the Revenue at the time of final adjudication of the pending appeal, including additional ground permitted to be raised before it.

iv. Accordingly, the High Court dismissed Revenue's writ.

2 ***Rolls-Royce Plc vs. Deputy Director of Income Tax***

[TS-756-HC-2019(DEL)], ITA 969/2019, ITA 970/2019, ITA 972/2019, ITA 973/2019, ITA 974/2019 Assessment Year: 2004-05 to 2007-08, 2009-10

The Court dismissed assessee's appeal and upheld Tribunal order which in turn followed its earlier order since the assessee (a) could not point out as to how the current year facts were different (b) raised new pleas which were not raised earlier

Facts

i. The assessee appealed to the High Court against an order of the Tribunal.

ii. The Tribunal had rejected appeals filed by the appellant *inter alia*, on the premise that the High Court had held in favour of the Revenue *vide* its decision dated 30th August, 2011 that Rolls-Royce India Ltd ("RRIL"), a hundred percent subsidiary of the appellant, constituted Permanent Establishment ("PE") of the appellant in India.

iii. Counsel for the appellant submitted that the Tribunal had erred in proceeding on the basis of the said decision of the High Court, since in taxation matters, concept of *res judicata* does not apply and the issues arising in each year have to be considered afresh.

iv. Appellant also submitted that the amendment incorporated in the second *Explanation* in section 9(1) of the Income-tax Act with effect from 1 April, 2019 would not have retrospective application.

v. Appellant also contended that the income of the assessee, on the basis that RRIL constituted its PE, had already been subjected to tax in the hands of PE i.e. RRIL, and the Revenue was seeking to tax the same again.

Decision

i. The Court held that it was for the appellant to point out as to how the facts pertaining to the relevant assessment years were different from the facts on which the decision for the previous assessment years was rendered. However, the appellant had not been able to point out any such pertinent difference in facts.

ii. With respect to the *Explanation* in section 9(1), the Court held that the submission of the appellant had no merit, as while determining the issue of whether RRIL constituted the PE of the appellant, the authorities had not relied upon the said *Explanation* at all.

iii. With respect to the contention that income of the assessee, on the basis that RRIL constituted its PE, had already been subjected to tax in the hands of PE i.e. RRIL, the Court held that this aspect did not raise a substantial question of law, since it was clearly a factual issue. Additionally, it was held that the order of the CIT(A) was available when the High Court rendered its decision on 30th August, 2011. Since no such plea was raised then, it was not open to the appellant to raise it now.

iv. Thus the appeals were dismissed.

B. TRIBUNAL DECISIONS

3 ***Dar Al Handasah Consultants (Shair & partners) India Private Limited vs. DCIT***

[TS-1122-ITAT-2019(PUN)-TP]

Assessment Year : 2010-11

Transfer Pricing – Deduction u/s. 10A - Is the assessee entitled to Section 10A deduction on additional income in respect of TP-adjustment offered in modified tax return filed pursuant to resolution under APA for AY 2010-11 – Held: Yes

Facts

1. During AY 2010-11, the assessee, Dar Al Handasah Consultants (Shair & Partners) India Private Limited, filed its original return declaring total income of ₹ 45.21 lakh. The Assessee had reported an international transaction of ITeS with transacted value of ₹ 37.54 crore and thereafter the AO made a reference to the TPO for determining ALP. The TPO selected certain comparables with their average PLI of OP/OC at 26.26%, which resulted in TP adjustment. Pursuant to DRP's directions, AO in the final assessment order dated 30-01-2015 passed u/s. 143(3) r.w.s. 144C(13) made TP-addition of ₹ 2.75 crore.

2. In the meantime, the assessee entered into an APA with the CBDT on 24-11-2015, in which the Operating Profit margin of not less than 17% was agreed under TNMM. Pursuant to the APA, assessee filed a modified return in terms of Section 92CD(1) for AY 2010-11, which was a part of rollback years, showing total income at ₹ 45.21 lakh, which was the same sum as was declared in the original return of income. The only change which occurred in the modified return was that assessee increased the profit margin to 17%, in consonance with the APA, from the originally declared profit margin of 15%, which resulted in enhancement of income by a sum of ₹ 20.36 lakhs. Simultaneously, assessee claimed a further deduction u/s. 10A for the amount equal to the enhanced income, as a result of which no further additional income was offered.

3. The AO, in its order dated 30-3-2017 passed u/s. 143(3) r/w Section 92CD, did not accept assessee's claim for the enhanced deduction on the additional income of ₹ 20.36 lakh primarily on the ground that the modification in the return u/s. 92CD(1) was permissible only to the extent of stipulation in the APA and the APA in question did not provide for any such deduction. AO took note of the mandate of Section 10A(3) which provides that the sale proceeds in respect of export of software should be brought into India in convertible foreign exchange within a period of six months from the end of the relevant previous year. AO considering that the enhancement in the amount of sale value was brought into India in convertible foreign exchange after such prescribed period held that the assessee was not entitled to further deduction u/s. 10A to the tune of ₹ 20.36 lakh. On appeal, CIT(A) upheld AO's view.

Decision

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

1. The Tribunal noted that there was no quarrel on the fact that the assessee originally filed return claiming deduction u/s. 10A, which was also allowed by the AO except to the extent of TP-adjustment. In this backdrop, the Tribunal stated that the question that arose now was to whether assessee was entitled to further deduction u/s. 10A on the additional income offered in the modified return.

2. The Tribunal observed that foundation of the action of the authorities below for the denial of deduction was premised on the

understanding that the modified return cannot breach the mandate of the APA, which, in turn, restricts its scope only to the determination of ALP and nothing more than that. In this context, on examining Section 92CC with the caption "Advance Pricing Agreement", the Tribunal observed that the crux of these provisions was that the arm's length margin or price is settled as per the terms of the APA, the manner of determination of ALP may be by any of the methods referred to in Section 92C(1) or any method de hors the prescription of Section 92C(1) and the provisions of Section 92C (Computation of ALP) and Section 92CA (Reference to the TPO) shall not apply in respect of the ALP determination under the APA.

3. The Tribunal also referred to Section 92CD which deals with giving 'Effect to the advance pricing agreement' and observed that as per sub-sections (3) and (4) of Section 92CD, *"once an assessee has filed modified returns under sub-section (1) of section 92CD, the AO is obliged to make/ complete the already completed or pending assessments u/s. 92CD itself afresh having regard to or in accordance with the terms of the APA."* The Tribunal further pointed out that Section 92CD(5) also enshrines limitation period for making/completing such assessments. The Tribunal thus concluded that, *"the Act contains a separate designated procedure for dealing with the assessments pursuant to the APA, which also contains distinct time limits in this regard."*

4. While proceeding with examining the question as to whether assessee was entitled to deduction u/s. 10A in assessment u/s. 92CD on the additional income offered in the modified return, the tribunal believed that the answer to the question could be found out by answering the following three sub-questions:-

(a) Whether proviso to 92C(4) debars deduction u/s. 10A on additional income in assessment u/s. 92CD?

The Tribunal considered AO's claim that assessee cannot be allowed deduction u/s. 10A in respect of incremental income offered in the modified return, which as per the AO, was eloquently proscribed by the proviso to subsection (4) of Section 92C/92CA. In this context, the Tribunal referred to Section 92C which deals with the computation of ALP by the AO and observed that sub-section (4) provides that where an ALP is determined by the AO under sub-section (3), AO may compute the total income of the assessee having regard to the arm's length price so determined. Proviso to this sub-section, which is the bedrock for the denial of the assessee's claim, states that *".... no deduction u/s. 10A . . . . . . shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section"*.

The Tribunal observed that under Section 92CA, through which a reference is made by the AO to the TPO for ALP determination and thereafter assessment is finalized by the AO in terms of TPO's order, provides through sub-section (4) that on receipt of order from the TPO, `the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C' in conformity with the ALP determined by the TPO.

The Tribunal stated that notwithstanding the ALP determination by the AO or the TPO, the assessment is finalised by the AO in terms of the mandate contained in sub-section (4) of Section 92C, which specifically provides that no deduction u/s. 10A shall be allowed in respect of the amount of income by which the total income is enhanced after computation of income under this sub-section. The Tribunal pointed out *"A close scrutiny of the crucial words in the proviso decodes that the denial of deduction is permissible only when, first there is computation of income under sub-section (4) of sections 92C/92CA of the Act and second, the total income is enhanced because of such computation, namely, by virtue of the transfer pricing adjustment."* The Tribunal explained that *"it is vivid that the proviso restricting the granting of deduction u/s. 10A on enhanced income applies only where the computation of income is made under the sub-section (4) of sections 92C/92CA, which talks of making some transfer pricing addition by the AO."* Accordingly, the tribunal clarified that, *"If the computation of income is neither u/s. 92C nor 92CA, namely, no transfer pricing addition is made by the AO, then it is obvious that the proviso shall have no application and the* fortiori *is that there will not be any denial of deduction under the sections given in the proviso."*

The Tribunal considered the scheme of assessment u/s. 92CD pursuant to the APA, under which assessee was mandated to file modified returns in consonance with the APA. The Tribunal observed that thereafter, assessment was made by the AO u/s. 92CD(3)/(4) in accordance with the APA and since the incremental income was offered by the assessee itself in the modified return in accordance with the APA, *"it cannot be equated with the computation of income u/ss. 92C/92CA of the Act, as the later provisions talks of making some transfer pricing addition by the AO."* The Tribunal also pointed out that, "*suo motu* offering of additional income by the assessee pursuant to the APA is of the same nature as the assessee itself offering some transfer pricing adjustment in the original return of income. In that case also, deduction u/s. 10A, if otherwise permissible, would be allowed and not curtailed as it will not be a case of transfer pricing addition made by the AO." Thus, the Tribunal opined that "deduction u/s. 10A cannot be disallowed in respect of additional income offered in the modified return as it is not a transfer pricing addition made by the AO but the additional transfer pricing income offered by the assessee in consonance with the APA with the CBDT."

The Tribunal further pointed out that second component for magnetizing the proviso is that the 'total income of the assessee is enhanced'. The Tribunal noted that an enhancement of income pre-supposes some action of the authorities after the filing of the return of income by assessee, which has the consequence of increasing the total income from the one declared by the assessee. In this context, the tribunal observed that filing of the modified return u/s. 92CD with the income as agreed between assessee and CBDT under the APA is an 'act of the assessee' in offering the additional income and 'not an act of the AO' in making the enhancement of the total income. Accordingly, observing that assessee itself had filed a modified return of income at the mutually agreed rate of 17% under the APA, the Tribunal held that *"there cannot be any question of the AO making* *any enhancement in the income as a result of transfer pricing adjustment so as to attract the proviso to section 92C(4) of the Act."*

Thus, the Tribunal concluded that *"proviso to section 92C(4) does not per se debar deduction u/s. 10A on additional income in assessment u/s. 92CD."*

(b) Whether assessment u/s. 92CD provides for granting deduction u/s. 10A?

Examining Section 92CD(2), the Tribunal observed that sub-section itself provides that *"if an assessee is otherwise eligible for deduction under any other appropriate provision in respect of the income offered in the modified return, there cannot be any embargo on granting deduction under such relevant provision."* The Tribunal noted that this saving clause contained in sub-section (2), making all other provisions of the Act applicable in the assessment of the modified return, includes applicability of Section 10A as well, subject to the fulfillment of others conditions as set out in the section. Opining that *"if an assessee is otherwise entitled to deduction u/s. 10A, or for that matter under any other provision of the Act, in respect of the income offered in the modified return, the same cannot be denied"*, the tribunal rejected AO's view that in absence of any specific provision in Section 92CD for granting of deduction u/s. 10A, no deduction can be allowed, as sans merit.

Thus, the Tribunal concluded that, *"assessment u/s. 92CD provides for granting deduction u/s. 10A of the Act."*

(c) Whether the assessee satisfied the conditions of deduction u/s. 10A?

On perusal of Section 10A(3), the Tribunal observed that *"the condition for bringing into India the requisite convertible foreign exchange within a period of six months from the end of the previous year is not be all end all of the issue."* Further considering that the sub-section (3) also extends to *"such further period as the competent authority may allow in this behalf", the tribunal opined that "if the competent authority has allowed further period for bringing into India the convertible foreign exchange, the assessee will be entitled to deduction u/s. 10A."* The Tribunal further pointed out that *Explanation 1* to Section 10A(3) states that "competent authority" means the RBI or such other authority as authorized under any law for the time being in force for regulating payments and dealings in foreign exchange.

The Tribunal noted that Section 92CC(1) mandates that CBDT enters into an APA with the approval of the Central Government and thus APA is a package deal aimed at reducing litigation. The Tribunal also stated that, *"If the APA contains some clause relaxing the rigour of any provision or to facilitate the tribunal in its workability, such a clause will prevail over the normal provisions of the Act."* Further, also referring to Section 92CC(2) [which states that a person shall furnish a modified return in accordance with and limited to the agreement], the Tribunal stated that a corollary which follows on a harmonious construction of sub-sections (1) and (2) of Section 92CD is that *"if the APA contains a clause departing from the normal provisions, it is such clause which shall prevail upon the normal provision."*

The Tribunal referred to Clause 7 of the APA entered into between assessee and CBDT which dealt with the "Critical assumptions" and provided that 'the critical assumptions (as referred to in the Rules) shall, for the purposes of this Agreement, be as specified in Appendix II.' Scrutinizing Clause 5 of the Appendix II dealing with 'Invoicing and Credit terms', the Tribunal observed that the CBDT provided for raising the invoice for additional amount and also 'realise it' in the month following the month in which the APA was signed. Keeping it simple, the Tribunal stated that *"the CBDT not only stipulated for raising of the invoice for the additional income but also for the realisation of the additional amount within the month following the month in which the Agreement is signed."* The Tribunal thus opined that the APA contained a clause for realizing the amount or bringing into India convertible foreign exchange for the additional amount of invoice within one month's period. The Tribunal further held that *"There can be no other reason for mandating in the APA for bringing into India convertible foreign exchange within one month following the month in which the APA is signed except for the granting the consequential benefits of such realization, even though sub-section (1) of section 92CD gives time of three months for filing the modified return."*

The Tribunal further stated that APA had made it mandatory for the assessee to bring in convertible foreign exchange in India within one month but for granting the relevant deductions connected with the realization of convertible foreign exchange in India, there was no purpose to stipulate it in the APA. Accordingly, the Tribunal opined that, *"This stipulation is, thus, a direction to grant deduction u/s. 10A only if the assessee succeeds in bringing in convertible foreign exchange in India within one month, bringing the case within the saving clause of sub-section (2) of section 92CD."* Considering that assessee brought into India the convertible foreign exchange within the stipulated one month period, the tribunal held that *"it became entitled to deduction u/s. 10A."*

Lastly, the Tribunal noted that para 2 of Clause 6 of the APA provided that ALP determination for rollback years was subject to the condition that the ALP would get modified to the extent that it did not result in reducing the total income or increasing the total loss, as the case may be, since assessee had already declared in the return of income for given AY. In context of this, the tribunal observed that total income of ₹ 45.21 lakh declared by the assessee in the original return remained at the same level in the modified return after the increase in the income due to the APA and with the simultaneous claim of deduction u/s. 10A. Stating that *"it is neither a case of reducing the total income nor increasing the total loss*", the tribunal thus held that *"assessee has satisfied the condition of deduction u/s. 10A(3) read with section 92CD(2)."*

5. Therefore, allowing assessee's appeal, the tribunal held that "proviso to section 92C(4) does not debar deduction u/s. 10A on additional income in assessment u/s. 92CD." Further held that "assessment u/s. 92CD provides for granting deduction u/s. 10A." Lastly, noting that assessee satisfied the requirement of Section 10A(3) r.w.s 92CD(2), the Tribunal held that it entitled assessee "to deduction u/s. 10A on the additional amount of ₹ 20,36,023/-."

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CA Adit Shah

GST Gyan – Transferable Development Rights 2.0 – After 29th March 2019

Introduction

The GST Council on 29th March 2019, has introduced a slew of changes on the implications of GST in the real estate sector covering rate changes, valuation mechanisms, exemptions and liability of certain individuals to pay under reverse charge basis. This effectively ushered in a new regime of GST 2.0 in Real Estate.

This article will speak about one of the most complicated and debated topics in real estate i.e., Transfer of Development Rights (TDR) and the implications of the new changes made on 29th March 2019 on TDR.

I. TDR – Whether Immovable Property or Service

Schedule III of the CGST Act states that the following shall neither be service nor sale of goods

"Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building."

The expression "land" does not find place in definitions given under the GST Act and hence a general definition of land must prevail.

It is relevant to note that land under Entry 18 of List II of VII Schedule reads as under

"Land, that is to say, rights in or over land, land tenures including the relation of landlord and tenant, and the collection of rents; transfer and alienation of agricultural land; land improvement and agricultural loans; colonization". The reference to land includes rights in land.

The following judgments establish that development rights are in the nature of immovable property:-

1. ***Santosh Jayaswal vs. State of M.P., (1995) 6 SCC 520*** – where the Hon'ble Supreme Court referred the General Clauses Act to state that

immovable property includes benefits arising out of land.

2. ***Chheda Housing Development Corporation vs. Bibijan Shaikh Farid, (2007) 3 Mah LJ 402*** - The Hon'ble Bombay High Court referred various judgments and sec. 3(26) of the General Clauses Act before coming to the conclusion that development rights are indeed benefits arising out of land.

Further Section 3(26) of the General Clauses Act, Section 3 of the Transfer of Property Act, Section 2(6) of the Registration Act enumerate that immovable property includes benefits arising out of land.

The above case laws and references provide sufficient evidence to dispute that TDR is a benefit that arises out of land as stated by the Bombay High Court in ***Chheda Housing Development Corporation vs. Bibijan Shaikh Farid, (2007) 3 Mah LJ 402*** and any benefit that arises out of land is an immovable property as enumerated by the Hon'ble Supreme Court in S***antosh Jayaswal vs. State of M.P., (1995) 6 SCC 520.***

II. Person liable to pay

Notification 07/2019 dated 29th March 2019 identifies a promoter as the person receiving the service. Promoter being the service recipient shall be liable to pay tax. Promoter has been defined under this notification as to have the same meaning as assigned to him by RERA Act, 2016 under clause (zk).

Notification 06/2019 dated 29th March 2019 notifies registered persons u/s. 9(4) who are liable to pay under reverse charge for receipt of transfer of development right. They have been mentioned as under

"a promoter who receives development rights or Floor Space Index (FSI) (including additional FSI) on or after 1st April, 2019 for construction of a project against consideration payable or paid by him, wholly or partly, in the form of construction service of commercial or residential apartments in the project or in any other form including in cash;"

The above notification notifies the developer to be the person liable to pay under reverse charge on the receipt of TDR by him for a consideration.

III. Rate of Tax

The rate of tax for providing a service in the form of TDR is derived from the SAC Code of 9972. SAC Code of 9972 includes real estate services. The rate of tax under 9972 for TDR is 18%.

IV. Valuation

The value of supply of service by way of transfer of development rights by a person to a promoter is stated under paragraph 1A of this notification

"1A. Value of supply of service by way of transfer of development rights or FSI by a person to the promoter against consideration in the form of residential or commercial apartments shall be deemed to be equal to the value of similar apartments charged by the promoter from the independent buyers nearest to the date on which such development rights or FSI is transferred to the promoter."

The value of TDR shall be deemed to be equal to the value of similar apartments charged by the promoter to his independent buyers nearest to the date of transfer of TDR by the land owner to the developer. This is explained as under.

For Example

XYZ Ltd, a developer enters into an agreement with ABC land owner for transfer of development rights for a consideration in lieu of constructed flats on 1st April 2019. The builder sells 10 **commercial** flats to independent buyers on 10th May 2019. The value of TDR to be considered while paying tax on issuance of completion certificate will be as per the value of flats sold to independent buyers on 10th May 2019 irrespective of the value existing on the date of completion certificate.

Furthermore on withdrawal of exemption (as discussed below under cases under which exemption will be withdrawn) for exemption of TDR on residential flats, there will be an RCM liability which will be triggered to the extent of the unbooked residential flats.

The proportion of the value at which Tax shall have to be paid on TDR shall be calculated as under

$$\frac{\text{GST payable on TDR or FSI (including additional FSI) for construction of the residential apartments in the project} \ * \ \text{Carpet area of the residential apartments in the project}}{\text{Total carpet area of the residential in the project}}$$

The Notification further states

"Provided further that tax payable in terms of the first proviso hereinabove shall not exceed 0.5 per cent of the value in case of affordable residential apartments and 2.5 per cent of the value in case of residential apartments other than affordable residential apartments remaining unbooked on the date of issuance of completion certificate or first occupation."

The same has been explained *vide* an illustration below

Where the total tax on 50 unbooked residential apartments is calculated as under

Particulars	***Amount***
Value per flat	₹ 50,00,000
Unbooked Area	30,000 Sq ft
Total Area	1,00,000 Sq ft
Consideration paid for TDR	₹ 10,00,00,000

Tax Payable on unbooked flats = 50,00,000 * 50* 2.5% = 62,50,000

Calculation of Tax Payable on TDR =

$$\frac{10,00,00,000*18\%*30,000}{1,00,000} = 54,00,000$$

Hence the above calculation does not exceed the amount of tax payable on unbooked flats. Hence tax payable on TDR shall be ₹ 54,00,000.

Few definitions to be understood for effective valuation are definitions of "Carpet Area", "Apartment" etc. For carpet area the notification states that it shall have the same meaning assigned to it in clause (k) u/s. 2 of RERA Act. Clause 2(k) of RERA Act states that :-

"carpet area" means the net usable floor area of an apartment, excluding the area covered by the external walls, areas under services shafts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by the internal partition walls of the apartment".

For apartment we will again have to refer sec. 2(e) of the RERA Act which states

"apartment" whether called block, chamber, dwelling unit, flat, office, showroom, shop, godown, premises, suit, tenement, unit or by any other name, means a separate and self-contained part of any immovable property, including one or more rooms or enclosed spaces, located on one or more floors or any part thereof, in a building or on a plot of land, used or intended to be used for any residential or commercial use such as residence, office, shop, showroom or godown or for carrying on any business, occupation, profession or trade, or for any other type of use ancillary to the purpose specified;"

V. Exemption

The GST Council introduced a slew of notifications on 29th March 2019 on the construction sector. With respect to TDR, the notification under 04/2019 essentially brought TDR under the exemption notification 12/2017 dated 28th June 2017 in certain cases. It states that the rate of tax for the following service shall be Nil.

"Service by way of transfer of development rights (herein refer TDR) or Floor Space Index (FSI) (including additional FSI) on or after 1st April, 2019 ***for construction of residential apartments by a promoter in a project,*** *intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier.*

The amount of GST exemption available for construction of residential apartments in the project under this notification shall be calculated as under:

$$\frac{\text{GST payable on TDR or FSI (including additional FSI)} \;*\; \text{Carpet area of the residential apartment in the project}}{\text{Total carpet area of the residential and commercial apartments in the project}}$$

VI. Cases where exemption is not available/or is withdrawn?

Notification 04/2019 is clear in stating that the exemption for TDR is only available to the extent of residential apartments. In case of commercial apartments, the exemption under this notification shall not be available.

Notification 04/2019 further states that a proportion exemption on TDR shall be withdrawn if a portion of residential apartments remain unbooked on date of issuance of completion certificate.

Notification 05/2019 dated 29th March 2019 hence seeks to include the above service to the extent of unbooked apartments under the RCM Notification. The specific service included by the mentioned notification is as under

"Services supplied by any person by way of transfer of development rights or Floor Space Index (FSI) (including additional FSI) for construction of a project by a promoter."

VII. Time of Supply

Notification 04/2019 states

"The liability to pay central tax on the said portion of the development rights or FSI, or both, calculated as above, shall arise on the date of completion or first occupation of the project, as the case may be, whichever is earlier."

However, Sec 13(3) of the CGST Act, 2017 deals with time of supply paid on reverse charge basis

In case of supplies in respect of which tax is paid or liable to be paid on reverse charge basis, the time of supply shall be the earlier of the following dates, namely:–

(a) the date of payment as entered in the books of account of the recipient or the date on which the payment is debited in his bank account, whichever is earlier; or

(b) the date immediately following sixty days from the date of issue of invoice or any other document, by whatever name called, in lieu thereof by the supplier:

The simple conclusion for the above mentioned provision is that the notification intends to indicate the time of supply for RCM Liability to be on the date of first occupation or date of completion whichever is earlier.

However it has to be seen that the above notification goes beyond section 13(3) and section 148 of the CGST Act, 2017 to prescribe time of supply for the above mentioned transaction. Notably the notification does not have any provision to effect an amendment to section 13(3) neither does it intend to go beyond the Section as it has not added a *"non obstante clause"* to the provision intended. Also where the notification mentions section 148 of the CGST Act, 2017, the powers under section 148 only extend to specifying certain persons and procedures to be followed by them in respect to furnishing returns, payment of tax and registration. It does not extend to specifying provisions for time of supply.

Hence whether the notification prevails over the section will have to be seen closely.

Conclusion

The exemption notification under Notification 04/2019 indicates that the legislators have decided that the Transferable Development Rights are not meant to be a part of Sch III. It is to be taxed as a service.

Yet what remains to be decided is that where no clear definitions of either TDR, immovable property or land are given under the GST Law, whether clear definitions of the same under various other laws and settled judicial pronouncements as mentioned above can be taken as a reference point to take a stand on the same.

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CA Naresh Sheth & CA Jinesh Shah

GST – Recent Judgments and Advance Rulings

A. Ruling by Appellate Authority for Advance Ruling

1. MRF LIMITED – AAAR TAMIL NADU (2019-TIOL-61-AAAR-GST)

Facts, Issue involved and Query of Appellant: Appellant intends to enter into an agreement with M/s. C2FO India LLP, for setting up an interactive automated data exchange. The C2FO platform provides interaction, relating to sale and purchase of goods and services, between buyer and seller registered on the platform provided by C2FO.

By accepting the C2FO terms and conditions, the supplier will agree to offer certain discount in return for an early payment of an Invoice from the recipient of goods or services (i.e. the appellant). On the online platform C2FO, the buyer (appellant) can accept discount and make payment. Then a commercial credit note would be issued.

Once the goods or services are delivered and the invoice is booked in the ERP and marked as approved to pay, the supplier via C2FO can take voluntary decision and give discounts to the buyer to receive early payment. The recipient on receipt of the goods or services takes ITC as mentioned in the invoice. The discount arrangement, being a post-invoice discount, is not part of the Purchase Contracts or the invoices. It is as good as Cash Discount not agreed before or at the time of supply.

Appellant had sought advance ruling as to *whether the company can avail the ITC of the full GST charged in the supply of invoice or a proportionate reversal of the same is required in case of post purchase discount given by the supplier of the goods or services.*

Appellant stated that they do not fall under Section 15(3)(a) or (b) of CGST Act, 2017, hence the value of supply should be full undiscounted value. As per Section 15(3) of the CGST Act, discount is not allowable for deduction from the price at the time of supply since the same is not known either before or at the time of supply. The taxable value for the purpose of payment of GST will be the value as per Purchase Contract without considering such discount so offered and the supplier is liable to pay tax on the value before discount.

The buyer pays **price** *minus* **the discount** *plus* **GST on the value without considering discount.** The applicant submitted that the payment made by the recipient has to be considered as proper payment in compliance with Section 16(2). There is no requirement to reverse ITC by the recipient attributable to the amount of discount so allowed for the reason that such discount is not considered by the supply for payment of GST and the appellant is not entitled to issue any credit note for the discount amount including GST in terms of Section 34(1) and (2). It stated that there is no need to reverse the ITC availed in proportion to the discount in the invoice price.

Discussions by and observations of AAR

AAR observed that the supplier on raising the invoice (undiscounted price) pays the applicable GST and appellant avails ITC. Thereafter, such invoice is staged for discount against early payment in the C2FO platform and the price is discounted.

In this case, the value of supply is the **full-undiscounted** value indicated in the tax invoice and the recipient only makes payment to the extent invoice less the discount thrown up by the C2FO software. As per section 16, the recipient is entitled to avail the ITC on the payment made by him alone and if any amount is not paid as per the Value of Supply and the recipient has availed full ITC, the same would be added to his output tax liability.

Therefore, in the instant case, the appellant can avail ITC only to the extent of the invoice value less the discounts. If he has availed ITC on the full amount, he should reverse the difference amount equal to the discount, to avoid adding to his output liability.

Ruling of AAR

ITC can be availed by the appellant only to the extent of the invoice value raised by the supplier less the discounts as per C2FO software, which is to be paid by the buyer (appellant) to the supplier.

Appeal to the AAAR and Observations of AAAR

Aggrieved by the decision of AAR, the appellant filed the appeal on following grounds:

- The impugned ruling ignores the fact that there exists a difference between commercial price and the value of taxable supply for the purpose of GST;
- The interpretation adopted by the AAR is wholly erroneous as:
  - o it denies ITC in case of both the persons who have paid the full commercial price to the supplier and who have not paid the full commercial price;
  - o it is contrary to the position set out in clarification of CBEC *vide* Circular No. 122/3/2010-S.T. dated 30-4-2010 in the context of Rule 4(7) of the CENVAT Credit Rules 2004, wherein it is clarified that 'in the cases where the receiver of service reduces the amount mentioned in the invoice and makes discounted payment, then it should be taken as final payment towards the service.
- AAR misinterpreted second proviso to Section 16 '**the amount towards the value of supply along with tax payable thereon'.** The proviso only requires the amount contractually/commercially agreed upon by the recipient to be paid to the supplier. The legislative intention is to merely ensure that suppliers are paid the commercially agreed price on time and deny GST credit if this is not done.
- None of the conditions/requirements as stated u/s. 16(1) are defaulted in the present case. Hence, when the fundamental requirements are satisfied, denial of the just input tax credit on the narrow interpretation is not maintainable.
- Said proviso has to be read in harmony with main provision of Section 16 which makes the recipient eligible for ITC. It cannot defeat main purpose of Section 16.

- Said proviso read with Rule 37 of the CGST Rules, 2017 apply to cases of failure to pay the value and tax to the supplier **and** not cases where value paid to the supplier is reduced as a result of mutual settlement. The reduced payment is not as a result of failure and the recipient should be held as eligible to take full Input Tax Credit.

Discussions by and observations of AAR

As per Section 9, GST shall be levied on the value as determined u/s. 15 of the Act. Section 15(1) states that the value of supply of goods or services shall be the transaction value, which is the price actually paid or payable to unrelated recipients. Section 15(3) is critical in determining the value of goods where discounts are involved. AAAR observed that none of the conditions of Section 15(3) are satisfied in the matter under reference.

Hence, the value would continue to be the value as determined u/s. 15(1) and there is no ambiguity in law. Further provisions of the second proviso to section 16(2) would come into play only where the buyer/recipient fails to pay the supplier of goods the amount towards the value of the supply. This is not the situation in present case.

It also examined CBIC's circulars referred to by the appellant. Circular No. 122/3/2010 dated 30-4-2010 issued by CBEC in the context of Rule 4(7) of the CENVAT Credit Rules, 2004 in respect of Services, states as follows:

(b) In the cases where the receiver of service reduces the amount mentioned in the invoice/bill/challan and makes discounted payment, then it should be taken as final payment towards the provision of service.

Circular No. 877/15/2008-Cx dated 17-11-2008, regarding reversal of CENVAT Credit in case of trade discount clarified the allowance of credit in the case where discount is given in respect of the value of inputs and not in respect of the duty paid by the supplier. Rule 3 of Cenvat Credit Rules, 2004 allows credit of duty "paid" by the inputs manufacturer and not duty "payable" by the said manufacturer. There are many judgements of Hon'ble Tribunal in this regard which have confirmed this view.

Like in the case of Rule 3 of Cenvat Credit Rules, 2004 which refers to credit of duty "paid" by the inputs manufacturer and not duty "payable", section 16 of the Act refers to the credit of input tax 'charged' and not "chargeable". The circulars thus supports the view that taxes paid and not subsequently reduced would be fully available as ITC.

Order of AAAR

Appellant can avail the ITC of the full GST charged on the undiscounted value of invoice. Appellant need not reverse ITC proportionately in case of a post purchase discount given by the supplier.

B. Rulings by Authority for Advance Ruling

2. M/s MAARQ SPACES PVT. LTD. (2019-TIOL-454-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is engaged in the business of property development. Applicant has entered into a Joint Development Agreement dated 8-11-2017 with landowners for development of land into residential layout along with specifications and amenities. The consideration was agreed on revenue sharing basis in the ratio of 75% for Landowner and 25% for applicant. Cost of the development was to be borne by Applicant.

Applicant has sought ruling in respect of the following questions:

a. *Whether the activity of development and sale of land attract tax under GST?*

b. *If the answer to the Question No. 1 is yes, for the purpose of taxable value, whether provision of Rule 31 can be made applicable in ascertaining the value of land and supply of service?*

Applicant's submissions

Entry 5 of the Schedule III provides that "Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building" shall neither be treated as supply of goods nor as supply of services. Hence, sale of land is excluded from the scope of "supply".

Applicant further submitted that on combined reading of definition of composite supply, principal supply and section 8 of CGST Act, it is understood that, where transaction involves two or more supplies, one of which is principal supply, then in such situation each supply will not be treated as separate supply, but become single supply. One is treated as predominant supply while the other supplies become incidental or ancillary to the predominant supply. Applying the same principle to the given transaction, predominant supply is that of land and development activity is incidental to the sale of land. Moreover, the development activity is naturally bundled with sale of land. In other words it is integrally connected with sale of land and therefore applicant is of the view that sale of developed plot is nothing but sale of land, which falls under Entry 5 of III Schedule to the Act and therefore not liable GST.

Without prejudice to above, applicant submitted that the price agreed with customers include cost of land as well as cost of development. Sale of land is excluded from scope of supply under Schedule III. Therefore, irrespective whether transaction is divisible or indivisible, sale of land shall be excluded from levy of GST. Provisions of Rule 27 to Rule 30 do not apply in given case and hence value needs to be determined in accordance with Rule 31 of CGST Rules, applying reasonable means. Therefore as per applicant exclusion of land value from total consideration or levy of tax on development charges only or cost plus reasonable profit shall be reasonable means consistent with the principle.

Discussions by and observations of AAR

The core contention of the applicant is that they are engaged in the sale of land and said activity is not liable to be taxed in terms of Schedule III of CGST Act. The activity of development work is incidental to and naturally bundled with sale of land. The predominant supply being sale of land, is not liable to tax and hence they are not liable to pay any tax on entire activity.

These contentions of applicant are examined in light of salient features of agreement. Consequent to the irrevocable joint development agreement, applicant enters into the land and has the right to survey, fence the property and secure the same by placing security personnel and other means. Applicant shall prepare necessary plans/drawings/designs, etc. and provide the same to landowners. It is the landowners' responsibility to obtain all the required licences, sanctions, consents, permissions, no-objections and such other orders required for obtaining the sanctioned plans. Once the landowners have obtained the required sanctions and permissions the applicant commences the development of the land. Applicant will carry out civil works such as surveys, fencing, levelling, etc. The agreement further provides that the applicant is required to engage architects, engineers, contractors and other professionals to execute the development work and all these personnel shall be the developer's employees. Agreement further states that applicant should possess necessary experience and expertise as a land developer. Further the applicant is entitled to recover all the cost from the purchasers of the plots. So far as the title of land is concerned it shall be exclusive responsibility of the landowner for all the claims and demands arising in relation to title of the land.

The *sine qua non* for any sale of land is the ownership of the land sold. The seller can claim that he is engaged in the supply of land by way of sale only and if he himself enjoys the title of the land. Anyone who does not possess any title of the land cannot be considered as the seller. Such a person may have a role in the activity of sale but he cannot claim himself to be the seller. In the instant case the applicant understands that they have a right to 25% of the total number of plots developed and the sale of these plots, as well as those of the landowners share, is covered under entry 5 of Schedule III.

The applicant has no right over the plots. The applicant only has a right to the extent of 25% of the amounts received on account of sale of the plots towards the cost of development incurred by them. AAR does not concur with the interpretation of applicant on following grounds:

- Applicant represents himself before landowner as a person having expertise as a land-developer. This shows competence of applicant to convert raw piece of land into developed land by carrying out survey, fencing, levelling, etc. These activities change nature of barren land and give it a character of marketable land.
- Activities to be undertaken by applicant are in nature of development of land into residential layout. Agreement provides that applicant can enter into sale agreement. However this activity is only incidental to main activity of development of land. Sale is entrusted to applicant as he has invested huge sum of money into the project and to protect his financial interests.
- There are various provisions in agreement which indicate that applicant has no right over the land [such as applying to governmental authorities for sanctioned plans].
- Applicant has no right over the plots. At the best applicant assists landowners in sale of plots belonging to landowner.
- Entire cost of development is to be borne by applicant. This implies that applicant is engaged to provide some services to the landowners. Applicant has no specific entitlement over the plots.

There are a good number of provisions in the agreement which indicate that the applicant has no right over the land and consequently applicant cannot claim to be engaged in the activity of sale of land as envisaged in the provisions of entry 5 of Schedule III. The provisions of this entry will apply only to those persons who are the owners of the land.

Applicant contends that in case their activity is deemed to be taxable, value should be determined in accordance with Rule 31 of CGST rules. Agreement provides that development cost shall be borne by applicant and he shall be entitled to recover the same from purchaser of plots. Applicant is entitled to 25% of revenue from sale of plots. This shows that revenue share received by applicant is nothing but its charges for the services provided to landowners. "Consideration" in relation to supply of goods or services or both includes any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, supply of goods or services or both, whether by the recipient or by any other person.

Applicant receives consideration equal to 25% of the value at which each of the plots is sold. This amount constitutes the consideration for the services provided by the applicant. Section 15 of the CGST Act, 2017 provides that the value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply where the supplier and the recipient are not related and the price is the sole consideration. The agreement provides that the applicant gets 25% of the amount at which each of the plots is sold. As and when a plot is sold the amount is shared and the applicant receives a part of their consideration. In this manner the applicant gets his consideration progressively. Therefore in terms of the provisions of Section 15, applicant receives the value of taxable supply made by them.

Rule 27 and Rule 28 does not have any implications here and hence Rule 31 comes into play. Value is to be determined using reasonable means and consistent principles. Consideration for service is the total value that service provider gets in a deal and not what he expends for provisioning of service. Total amount accruing to applicant is 25% of amount at which plot is sold to independent buyer. Since applicant is not engaged in sale of land, entire amount received by them is liable to be taxed.

Ruling of AAR

In respect of question (a), activities as envisaged in the agreement between the applicant and the landowners amount to supply of services and is liable to be taxed under GST.

In respect of question (b), Rule 31 applies in the instant case and the value of the supply is equal to the total amount received by the applicant, which is equal to 25% of the market value of each plot.

3. RASHTRIYA ISPAT NIGAM LIMITED (2019-TIOL-476-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is a Central Public Sector Undertaking under the Ministry of Steel with Navaratna Status engaged in the business of manufacture and selling of steel products. The steel plant consist of many sub plants which itself is a big unit and the final steel product undergoes process through various sub-plants.

Apart from procuring raw materials like iron ore, coking coal etc. in huge quantities, applicant also procures spare parts and machinery parts in huge quantities for maintenance of its plant(s). In various contracts entered into by company, there is a clause to deduct liquidated damages (LD) in case of default by the contractor/vendor to complete the work/supply in time. The LD is deducted in two types of cases:

Type 1: Operation & maintenance activities

RINL enters in to various contracts with vendors for providing materials and services for Operational activities. ln this case, if there is any delay on the part of the supplier/contractor to provide materials/services, Liquidated damages (LD) are deducted from the amount payable to such vendor.

Type 2: Construction of new plant in expansion project or renovation of old plant

ln this type of contracts, normally the contract is awarded to vendors to build the sub plant or a part of it on Turnkey basis. As per the terms and conditions the period of completing the contract is fixed. When plant construction is completed, lf the delay is on account of the contractor, then Liquidated Damages would be calculated as per the contractual terms and same will be charged from the contractor.

Further, in the case of turnkey contracts the execution of work is monitored by dividing the stages of execution as reaching various milestones. lf the execution of work is not as per the targets or milestones, achievements fixed, penalties also would be levied as milestone penalties before completing delay analysis. However, in the interim, the amounts equivalent to LD & milestone penalties are withheld from the bills.

In accounting Liquidated Damages/milestone penalties imposed are treated as other miscellaneous income. This would be taking place after completion of delay analysis.

Applicant has sought advance ruling on following questions:

a. *Whether "Liquidated damages" and other penalties like milestone penalties levied on suppliers/contractors in the nature of making good the damages for any delay in supply of services or goods in the following cases are exigible to GST or not?*

   i. *Supply and maintenance contracts*

   ii. *Projects construction contracts*

b. *If GST is applicable, the following may kindly be clarified:*

   i. *Whether the GST on Liquidated Damages, and other penalties is covered under Schedule II Entry No. 5(2) (e) vide HSN Code 9997 – other services, for which the rate at 18% is relevant or any other entry is applicable?*

   ii. *Liquidated Damages are determined and imposed upon the contractor after in-depth study. In such case, what would be the time of supply? Will it be period in which delay has occurred or it is the time when decision is taken or at the time when accounting entry for recovery is passed?*

   iii. *When some part of the delay in supply has occurred before the implementation of the GST and some part of delay in supply has occurred after GST came into force, whether GST will be applicable to the LD imposed for entire period of delay or it would be applicable only to the period falling after introduction of GST?*

Applicant's submissions

The applicant stated that the purpose of deducting the amount towards liquidated damages is to **indemnify** the loss to RINL due to non-receipt of goods or services as per the agreed terms and conditions by the vendors. There is no agreement between the applicant and the contractor/vendor wherein the company is intending to supply "service of tolerance of delay". It is never the intension of the applicant to get its project/supplies delayed nor do the contractors/vendors want to make delay and thereby causing applicant to tolerate it. Since the executed portion of the contract value already suffers GST, levying of further GST on damages or compensation measures like LD and milestones penalties imposes double taxation on the contract values.

As per Entry 5(e) of Schedule II of the CGST Act, an activity of "agreeing to the obligation to refrain from an action, or to tolerate an act or a situation, or to do an act" shall be treated as supply of services. The expression to 'tolerate an act' should be understood to cover instances where the consideration is being charged by one person in order to allow another person to undertake an activity. The expression 'agreeing to tolerate an act' cannot be construed to include situations wherein penalty is charged by a party for breach of terms and conditions of the contract committed by other party.

It has been consistently held that liquidated damage is to compensate the person for loss suffered by the person due to delay as mentioned in the contract. In the view of the above submissions, applicant prayed the advance ruling authority to consider that the damages in the form of LD or penalties are not subject to GST.

Discussions by and observations of AAR

Agreement between applicant and vendor/contractor provides that the liability of payment of these liquidated damages by the contractor will be established once the delay in execution of work is established on the part of the contractor. Thus, the act of delayed supply has happened. The same is being tolerated by the applicant by way of additional levy in the nature of liquidated damages. The agreement also provides that the payment by contractor or deduction by owner of any sums under the provision of this clause shall not relive the contractor from his obligations to complete the works or from his other obligations under the contract. This provision just ensured that the empowerment to levy liquidated damages is for the reason that there had been a delay and the same would be tolerated, but for a price or damages. Thus, the income though presented in the form of a deduction, would be a supply of 'services' by the applicant in terms of clause (e) of Para 5 of schedule II appended to the CGST Act, 2017.

Liquidated Damages would be classified under the Heading 9997 and the rate of tax applicable would be 18% (9% + 9%).

Another important issue of levy of GST is that at what time the liability to pay GST would occur. In terms of the agreement, the clauses revealed that the levy of Liquidated Damages is not when the delay is occurring but when such delay in successful execution of work is established on the part of contractor. This would define the time of supply. If contractor fails to execute work within specified time period, then liquidated damages would be attracted which would attract GST.

Ruling of AAR

In respect of question (a), GST would be applicable on the Liquidated Damages.

In respect of question (b):

i. Supply would be covered under the heading 9997.

ii. When delay in successful execution of work is established on the part of the contractor.

iii. Section 13(1) of CGST Act provides that the liability to pay tax on services shall arise at the time of supply. In view thereof, authority asked to refer agreement clauses. Further it simply asked to refer section 14 of the GST Act, since no precise facts were available with authority.

4. M/s. BABY MEMORIAL HOSPITAL LTD. (2019-TIOL-430-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is a multi-speciality hospital engaged in providing healthcare services to its patients. It has full-fledged facilities with all infrastructure, pharmacy lab, clinical laboratory, X-Ray and scanning facilities, ambulance and dietary services, supply of medicines and other allied services. It undertakes inpatient as well as outpatient treatments.

Applicant has sought advance ruling in respect of following questions:

a. Whether the applicant is liable to pay GST on supply of medicines, drugs and other surgical goods from its pharmacy to inpatients?

b. Whether the applicant is liable to pay GST on supply of medicines, drugs and other surgical goods from its pharmacy to outpatients?

c. Whether the applicant is liable to pay GST on supply of incidental services as X-Ray, clinical laboratory, etc. rendered as a part of healthcare services?

d. Whether the applicant is liable to pay GST on supply of implants and artificial limbs made during the course of treatment to patients?

Discussions by and observations of AAR

Healthcare services provided by clinical establishment is exempted under Notification No. 12/2017-CT (R). The word 'clinical establishment' includes hospital, nursing home, clinic, etc., which provides services or facilities for diagnosis or treatment or care for illness. As far as an inpatient is concerned, hospital is expected to provide care to patient which consists of visit and treatment by doctors, visit by nurses, supply of medicines, conduct of X-Ray, conduct of pathological tests, etc. Medicines, implants, room provided on rent, dietary food as advised, etc. used in course of providing health care services to the patients admitted in hospital is undoubtedly naturally bundled in ordinary course of business. Hence, medicine and allied goods supplied to inpatients are indispensable items and is a composite supply to facilitate health care services. AAR has given ruling in case of M/s. KIMS Healthcare Management Ltd., M/s. Rajagiri Healthcare and Education Trust, etc. to the effect that supply of medicines and allied items provided by hospital to in-patients is part of composite supply of health treatment and not separately taxable.

Further, in respect of liability to pay GST on supply of incidental services as X-Ray, Clinical laboratory, etc., rendered as part of healthcare services, AAR has already held in case of M/s. Medvision Scan and Diagnostic Research Centre Pvt. Ltd. that such services are nothing but health care services provided by clinical establishment and are therefore exempted.

Supply of artificial body parts/devices such as heart valve, artificial kidney, artificial joints, etc. which are implanted in body by means of surgical procedure can be classified as a part of composite supply where principal supply is of healthcare services.

In case of artificial body parts which are fastened to body for which surgical procedure may or may not be needed, taxability needs to be determined on case-to-case basis.

Supply of goods like wheel chair, tricycles, etc. to the patients cannot be classified as part of health care services.

Ruling of AAR

a. Supply of medicines, drugs, etc., to in-patients are part of composite supply of healthcare services and therefore exempted.

b. Supply of medicines, drugs, etc., to out-patients is a taxable supply of goods and therefore liable to GST.

c. Services by way of diagnosis come under healthcare services and therefore exempted.

d. Supply of artificial body parts/devices such as heart valve, artificial kidney, artificial joints, etc., which are implanted in body by means of surgical procedure can be classified as a part of composite supply where principal supply is of healthcare services.

In case of artificial body parts which are fastened to body for which surgical procedure may or may not be needed, taxability needs to be determined on case to case basis.

5. M/S. RANDOX LABORATORIES INDIA PVT. LTD. – AAR KARNATAKA (2019-TIOL-452-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is engaged in trading of diagnostic reagents and diagnostic equipments. Majority of sales are made to diagnostic centers through authorised distributors. In some cases it sells these reagents directly to customer. Applicant also provides aforesaid equipments on lease and also provides spares for these equipments. GST rate applicable on sale of reagent is 12% and on supply of equipment for use is 18%.

In case of sale made through agents, there are two types of contracts:

- **RRC (Reagents Rental Placement Contracts)** – where the equipment is provided on returnable basis and title remains with the applicant. The equipment is provided on a consideration that a minimum level of reagents will be purchased by the customer. If minimum level is not achieved, it will recover penal charges as per the agreement.

- **PRC (Part Reagents Rental Placement Contract)** - Where the contract is akin to RRC except the fact that an upfront non-refundable deposit is obtained from the customer.

Applicant has sought advance ruling in respect of following question:

- Whether the applicant is liable to pay GST on machines given to customers under RRC/PRC model?
- Whether the **supply of reagents along with the machine rental and services in a RRC/PRC contract** is a separate supply or a mixed supply or a composite supply? If considered as composite supply, what is principal supply?
- What is the rate of tax for the service of machine under RRC/PRC model?
- What is the value on which GST has to be paid in case of RRC/PRC model and what is the time of supply?
- Whether the applicant is eligible for ITC on the purchase of machinery for use in RRC/PRC model?

Applicant's submissions

Regarding question (a), applicant submitted that aforesaid transaction of supplying machine, reagents and services under RRC/PRC agreement for a consideration is covered u/ss. 7, 9 and 2(31) of CGST Act, 2017, so it will be liable to tax under GST.

In RRC contract, the applicant entered into an agreement for the supply of machines, reagents, services and spares in conjunction with each other in consideration that customer will purchase a minimum level of quantity of reagents. The reagents can be used only with the diagnostic equipment and cannot be used independently. This indicates that these are naturally bundled. The word naturally bundled is not defined in GST law. The indicative factors (as stated in CBEC educative guide) of naturally bundled can be discussed as under in present scenario:

- The perception of service receiver - large number of customers prefer RRC/PRC models since upfront cost of machine cannot be afforded by all customers.
- Majority of services provider provide similar bundle.
- The nature of goods and services involved in the bundle demonstrate that these are naturally together.
- The RRC/PRC contracts are advertised as a package.
- There is a single price for machine rental, reagents and services which are all combined into price for the reagents.

The core activity of applicant is to supply reagents and not the supply of machine. Sale value and profit margins of reagents in RRC/PRC contracts is significantly higher than that of machines. Supply of machine for use of reagents is just a marketing strategy to increase the sale of reagents. Hence, the supply should be treated as composite supply and where principal supply is reagents.

Regarding question (c), applicant submitted that rate of GST on whole supply is 12% (i.e. rate of reagents) since aforesaid supplies are composite supply as argued in (b) above.

Regarding question (d), applicant submitted that the tax should be levied on the transaction value u/s. 15 of CGST Act. In case of RRC/PRC contract, the transaction values are agreed therein i.e. consideration charged by the applicant for the reagents upon sale to distributors who in turn sells reagents to end customers.

In case of PRC contracts, a non-refundable deposit is received from customers which is to be treated as consideration and also liable to GST @ 12% (Being part of composite supply).

Time of supply shall also be determined based on **principal supply**, hence tax shall be payable upon sale of reagents to the distributors who in turn sell them to end-customers. The time of supply will not be the time of placement of machine at customers' premises.

Regarding question (e), the applicant submitted that the ITC is allowed if eligible u/s. 16 and not ineligible u/s. 17(5) of CGST Act which *inter alia* includes "goods disposed off by way of gift or free samples". In case of RRC/PRC contracts, the placement of machines at customer premises cannot be stated to be gifted or free samples since title remains with the applicant. These are provided as a part of composite supply in course or furtherance of business, therefore, ITC on inward supplies of machines (equipments) can be availed.

Discussions by and observations of AAR

AAR observed that there are two types of transactions i.e., RRC/PRC and examined them separately.

Reagent Rental Placement Contract

In this model, there is no consideration for providing equipments and ownership lies with applicant only. Therefore, same could not be called as supply u/s. 7 of CGST Act.

Section 7(1)(a) defines supply to include **rental of goods** if made for a consideration in course or furtherance of business. However there is no express consideration involved for this transaction.

Section 2(31) of the CGST Act defines the term "consideration". Present scenario falls under clause (b) of said definition as there is a inducement of supply of goods from the distributor and hence the monetary value of the act of supply of goods would be the consideration for the supply of equipments. Since the monetary value of this transaction is Rs. Nil, this cannot be considered as the consideration. Hence, supply of equipments without any charge under this model would not amount to supply under the Act.

The issue of time of supply of equipments by the applicant to the end-customer does not arise as there is no supply of equipments.

It is the discretion of applicant whether reagents are supplied directly by himself or order is fulfilled by authorised distributor, and an invoice is raised for each supply of reagents, either by the applicant or by authorised distributor, as the case may be.

In case the quantity of orders fall below a threshold, then customer is invoiced for deficient orders and this would be charged for violation of the terms of the agreement. This is a separate supply of "**agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act**" for which consideration is charged by the applicant.

Hence, there are following three transactions covered in a single contract:

(i) Provision of equipment free of charge - which is not a supply under the Act.

(ii) Supply of reagents either by the applicant or by the authorised distributor of the applicant out of their own stocks.

(iii) Supply of services in the nature of "an act agreeing to the obligation to refrain from an act, or to *tolerate an act* or a situation, or to do an act" for a consideration.

The three limbs are independent contracts (covered in a single contract) which are linked to each other. They have separate considerations.

Here the first contract does not involve consideration, so it is not treated as supply. Second contract is supply of goods and time of supply will be determined u/s. 12(2) of CGST Act. Third contract is provision of services by the applicant and time of supply will be determined u/s. 13(2) of CGST Act.

From the nature of these contracts, it cannot be said as naturally bundled and also there is no principal supply, so it would not be considered as composite supply.

Regarding the **value of the supplies** involved in the contract, the supplies of the reagents and the supplies of the services discussed above are taxable on the respective values determined u/s 15 of CGST Act. This would be normally on the value for which invoice is raised, which would be the transaction value. But in case of the free supply of equipment, the same does not amount to supply and is only a usage of a fixed asset.

Part Reagent Rental Placement Contracts (PRC)

In PRC all ingredients of RRC are present except that an upfront non-refundable deposit is received from customers and effective control of equipment is transferred to the customer. However, ownership lies with the applicant. Since this deposit is related to equipment, this amounts to consideration towards renting of equipments.

As far as other supplies (i.e., supplies of reagent and tolerating the act) are concerned, same scheme, as applicable to RRC contract, will apply here also.

As far as rates of tax are involved, following table summarized the same:

S. N.	***Supplies***	***Entry and GST Rate***
1	Transfer of right to use of equipments	Entry 17(iii) of N/N 11/2017-CT(R) Rate as applicable to supply of like goods involving transfer of title i.e. **9%**
2	Supply of reagents	Entry 80 of N/N 01/2017-CT(R) – **6%**
3	Tolerating an act	Entry 35 of N/N 11/2017-CT(R) – **9%** (Other services)

Regarding the eligibility of **ITC on purchase of equipments for PRC/RRC contracts,** AAR observed as under:

- Equipment is capitalized in the books of account;
- They are used in the course or furtherance of business;
- Applicant is eligible to take the credit of ITC, subject to the condition and limitation prescribed for capital goods u/s. 16(3) and 17 of CGST Act.

Ruling of AAR

a. The applicant is liable to GST on equipment given under PRC Model but is not liable to GST on equipment given under RRC model.

b. **The supply of reagents** along with the machine rental services in both RRC and PRC contract **is a separate supply** independent of equipment rental services.

c. GST rate for the supply of rental service of equipment is 9% CGST and 9% KGST.

d. The value on which GST has to be paid and the time of supply are:

   i. **For the supply of rental services in equipment** – at the time of supply of the equipment on amount of non-refundable deposit. (In case of PRC model only);

   ii. **For supply of reagents -** at the time of supply of reagents on the transaction value. (In case of both RRC/PRC contracts);

   iii. **For the supply of services in the nature of tolerating an act for a consideration -** at the time of supply of such services on transaction value (For both RRC/PRC contracts).

e. The applicant is eligible for ITC on the purchase of equipment for use in RRC/PRC contracts.

6. EX-SERVICEMEN RESETTLEMENT SOCIETY – AAR WEST BENGAL (2019-TIOL-493-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is a registered society providing Security & Scavenging Services to the medical colleges and hospitals under West Bengal Government and to the Central Government Cancer Institute.

Applicant has sought advance ruling as to whether exemption from payment of GST is available to them in terms of Notification No. 12/2017-CT (Rate) dated 28-6-2017?.

The nature of activities performed by the Scavenging Personnel comprise of:-

- Manual cleaning where required;
- Duties of attendant's viz., bringing of Medicine/Oxygen Cylinders from a particular store to different wards;
- Operating trolleys for the carriage of patients from the Emergency Ward to different wards, or from the Wards to the different laboratories for different tests, like blood tests, X-Rays, scans, etc.

Discussions by and observations of AAR

Exemption from GST is granted to Pure services provided to the Central Government, State Government or Union territory or local authority or a Governmental authority by way of any activity in relation to any function entrusted to a Panchayat under Article 243G of the Constitution or in relation to any function entrusted to a Municipality under Article 243W of the Constitution.

Applicant's eligibility under Entry No. 3 or 3A of the Exemption Notification should, therefore, be examined from three aspects:

(i) Whether the service being supplied is pure service or composite supply?;

(ii) Whether the recipient is government, local authority, governmental authority or government entity?; and

(iii) Whether the services provided are classifiable as a function entrusted to a Panchayat or a Municipality under the Constitution?

The department officer submitted that the above exemption is extended to Panchayats and Municipalities. The Applicant, being a private party, is not eligible for this exemption.

Pure services are not defined under GST law but in common parlance it means a supply where goods are not involved. Applicant is not supplying any goods while provisioning of the services. Applicant's services are, therefore, pure services.

The supplies are made to hospitals owned or managed by the government. It is, therefore, obvious that the recipient is government or governmental authority etc.

Before deciding the applicability of Entry No. 3 of the Exemption Notification, the functions of a Panchayat or a Municipality under the Constitution needs to be discussed. Article 243G of the Constitution discusses the powers, authority and responsibilities of **Panchayats**. It states as under:

"Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow

the Panchayats with such powers and authority and may be necessary to enable them to function as institutions of self-government .... subject to such conditions as may be specified therein, with respect to.......(b) the implementation of schemes for economic development and social justice as may be entrusted to them including those in relation to the matters listed in the Eleventh Schedule".

Article 243W of the Constitution discusses the powers, authorities and responsibilities of **Municipalities**. It states as under:

"Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow....... b) the Committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule".

Entry 26 to Eleventh Schedule under Article 243G covers "Health and sanitation, including hospitals, primary health centers and dispensaries".

Entry 7 to Twelfth Schedule under Article 243W covers "Public health sanitation, conservancy and solid waste management".

No other entries in the Schedules of the Constitution appear relevant while examining applicability of the Applicant's services bundled as "Scavenging Services".

"Health Care Service" is defined under para 2(zg) of the exemption notification. It means inter alia any service by way of diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognized system of medicine in India and includes services by way of transportation of patient to and from a clinical establishment. It is classified under SAC 99931. It does not include any of the services bundled under the description "Scavenging Services".

Again, "Sanitation and similar services are classified under SAC 99945. It includes sweeping and cleaning, but only with reference cleaning of a road or street. Cleaning of hospital premises is not, therefore, classified under "Sanitation or similar service".

The services the applicant bundled under the description "Scavenging Services" are, therefore, not exempt under Entry No. 3 of the Exemption Notification.

Ruling of AAR

Applicant is not eligible to avail benefit of N/N. 12/2017-CT (Rate) dated 28-6-2017 for the supply of Security Services and the bundle of service described as "Scavenging Services".

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INDIRECT TAXES

CA Rajiv Luthia & CA Keval Shah

Service Tax – Case Law Update

1 *M/s. HCL Learning Ltd. E-4, Sector-11, Noida, UP vs. Commissioner of Central Goods and Services Tax Noida*

2019-TIOL-3545-CESTAT-ALL

IN THE CUSTOMS, EXCISE AND SERVICE TAX APPELLATE TRIBUNAL REGIONAL BENCH, ALLAHABAD

COURT NO. I

Service Tax Appeal No. 70580 of 2018

Arising out of Order-in-Appeal No.NOI-EXCUS-001-APP-1597-17-18, dated: 10/01/2018

Passed by Commissioner (Appeals), Central Goods & Service Tax, Noida) Passed by the Pr. Addl. Director General (Adj.), DGGSTI New Delhi.

Date of Hearing: 25-11-2019

Date of Decision: 25-11-2019

Appellant Rep by: Shri Nishant Mishra, Adv.

Respondent Rep by: Shri Anupam Kumar Tiwari, AR

CORAM: Archana Wadhwa, Member (J) Anil G Shakkarwar, Member (T)

ST - In the present case the employer has been served with a show cause notice demanding service tax on that part of the amount which he recovers out of the salary paid to the employee, if the employee breaches the contract of total term of employment - It is noticed from the terms of contract between the appellant and his employee that the employee shall be paid salary and the term of employment is a fixed term and if the employee leaves the job before the term is over, then certain amount already paid as salary is recovered by the appellant from the employee - This part of the recovery is treated as consideration for charging service tax - demand confirmed by lower authorities, therefore, appeal to CESTAT.

Held

Said recovery is out of the salary already paid and moreover salary is not covered by the provisions of service tax, therefore, impugned order is set aside and appeal is allowed: CESTAT [para 2]

Appeal allowed

FINAL ORDER NO. 71950/2019
Per: Anil G Shakkarwar:

After hearing both the sides duly represented by learned advocate Shri Nishant Mishra appearing on behalf of the appellant and Shri Anupam Kumar Tiwari appearing on behalf of the Revenue, we note that in the present case the employer has been served with a show cause notice demanding service tax from that part of the amount which he recovers out of the salary paid to the employee if the employee breaches the contract of total term of employment. From the record, we note that the term of contract between the appellant and his employee are that employee shall be paid salary and the term of employment is a fixed term and if the employee leaves the job before the term is over then certain amount already paid as salary is recovered by the appellant from his employee. This part of the recovery is treated by Revenue as consideration for charging service tax term of contract between the appellant and his employee are that employee shall be paid salary and the term of employment is a fixed term and if the employee leaves the job before the term is over then certain amount already paid as salary is recovered by the appellant from his employee. This part of the recovery is treated by Revenue as consideration for charging service tax.

2. We hold that the said recovery is out of the salary already paid and we also note that salary is not covered by the provisions of service tax. Therefore, we set aside the impugned order and allow the appeal.

(Dictated and Pronounced in open Court)

(***DISCLAIMER***: *Though all efforts have been made to reproduce the order correctly but the access and circulation is subject to the condition that Taxindiaonline are not responsible/liable for any loss or damage caused to anyone due to any mistake/error/omissions.)*

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The human voice can never reach the distance that is covered by the still small voice of conscience.

– Mahatma Gandhi

As different streams having different sources all mingle their waters in the sea, so different tendencies, various though they appear, crooked or straight, all lead to God.

– Swami Vivekananda

Almost half of the population of the world lives in rural regions and mostly in a state of poverty. Such inequalities in human development have been one of the primary reasons for unrest and, in some parts of the world, even violence.

– A. P. J. Abdul Kalam

Company Law Update

Makarand Joshi,
Company Secretary

Judgment Summary

1. Companies Act, 2013
Regional Director, Southern Region, MCA, Chennai & Anr. (Appellant) vs. Real Image LLP, Chennai & Anr. (Respondent) (NCLAT, New Delhi) dated 4th December, 2019

Facts of the case

- M/s. Real Image LLP (transferor LLP) with M/s. Qube Cinema Technologies Pvt. Ltd. and their respective partners, shareholders and creditors moved joint company petition under Sections 230 to 232 of the Companies Act, 2013 in NCLT, Chennai Bench.
- NCLT, Chennai bench after applying the principal of *causus omissus* permitted amalgamation of the LLP into Private Limited Company *vide* order dated 11-6-2018.
- Being aggrieved, Regional Director, Southern region and Registrar Of Companies filed appeal under Section 421 of the Companies Act, 2013 (the Act)

Arguments
On part of Appellant:

Ld. Counsel on behalf of **appellant** argued that it is not correct to apply principal of *casus omissus* in the case of amalgamation of LLP to Company by stating that there is no provision for merger of Indian LLP into Indian Company in the Companies Act, 2013 because:

- A company can be merged with another company as per **Section 232(i)(a)** of the Act. Here Company means **"company" incorporated under Companies Act, 2013** or under any previous Company Law.
- Further as per **Section 366** of the Act, the **word company includes** any partnership firm, **limited liability partnership**, cooperative society, society of any other business entity firm under any law for the time being in force and such company can apply for registration **for the purpose of Part I, Chapter XXI**.
- If Indian LLP is proposed to merge in an Indian company then firstly the LLP has to apply for registration under Section 366 of the Act.

On part of Respondent
Ld. Counsel for **respondents** supports the view of NCLT, Chennai Bench. when a foreign body incorporated such a LLP can be amalgamated in

Indian company then why Indian LLP cannot be permitted to merge in Indian company. Prohibiting amalgamation of an Indian LLP with an Indian company would be absurd and discriminatory, thus the principle *casus omissus* is applicable. Further submitted that

- the amalgamation scheme has to be sanctioned by the same authority i.e. NCLT. there is no utility that LLP first convert into company then apply for merge
- the **right to re-structure** a business or corporate structure is implicit in the **fundamental right to trade**. Any **restriction** on such right must be **expressly provided by legislation**. It cannot be read into statute by implication
- On the **contrary**, statute must be **liberally interpreted to facilitate the constitutional scheme of freedom trade.**

Held

- It is implicitly clear that the legislature has enacted provisions in Companies Act, 2013 for conversion from the Indian LLP into Indian company and LLP Act, 2008 provides conversion from Firm, Private company and unlisted public company into LLP.
- NCLT rightly held that Companies Act, 1956 provides that any body corporate can merge into a company. However Section 234 of Companies Act, 2013 provides that foreign company or body corporate incorporated outside India can be merged into an Indian company.
- A *casus omissus* cannot be supplied by the court except in the case of clear necessity and when reason for it is found in the four corners of the statute itself. [1]Considering above, there is no such occasion to apply the principle of *casus omissus*.
- **Impugned order is not sustainable in law hence set aside.**

Readers can read article on order of Chennai Bench dated 11-6-2018 (*supra*) on following link (Refer Page. 42 to 44)

https://ctconline.org/wp-content/uploads/pdf/2018/chamber-journal/CJ_October_2018.pdf

2. IBC

In the matter of ***JSW Steel Ltd. (JSW) vs. Ashok Kumar Gulla & Ors. (Respondents) (NCLAT Judgement dated December 4, 2019)***

Facts of the case

In the CIRP of "Vardhman Industries Limited" (Corporate Debtor/CD) JSW became the Successful Resolution Applicant. The resolution plan was approved by NCLT, New Delhi (Bench-III) *vide* its order dated December 19, 2018 subject to three conditions namely:

A. **Right to receivables** -Any amount recovered by CD which was written off as bad debt(s) or which stood in book but had not been recovered as on date of approval of resolution plan by NCLT, would be, before being put to any other use, be used to pay balance amount to financial creditors and operational creditors of the CD

B. **Carry forward of losses** - That relief asked for carry forward losses as specified u/s. 79 be granted subject to approval of Income Tax Department

C. **Claims of subsidiaries etc.** - Any claims, privileges etc. made or to be made by any

1. *Union of India vs. Rajiv Kumar (2003) 6 Supreme Court Cases 516.*

subsidiary, associate and or joint venture company of CD against CD shall not be extinguished excluding such claims made by "JSW Vallabh Tinplate Private Limited"- a joint venture company

JSW sought clarifications and challenged conditions imposed by NCLT, New Delhi.

NCLT in its order dated April 16, 2019 clarified as follows:

Condition A - Right to receivables
Argument by JSW- The condition would materially affect the business plan and the purpose of plan and would further make resolution plan unviable. The amount to be paid to operational and financial creditors had been clearly specified and hence the condition should be deleted.

NCLT clarification- If recoveries are made by CD from existing debts which had been written off, then benefit of such extraordinary gain should not be enjoyed by CD but be distributed to other stakeholders as well.

NCLT thereafter amended the condition and made mandatory the distribution of such debts, if recovered, to dissenting financial creditors and operational creditors.

Condition B - Carry forward of losses
Argument by JSW- Referring to provisions of Section 79 Income Tax Act 1961, it was argued that no representation was made by Income Tax Department and hence opportunity as provided u/s. 79 of was not availed by Income tax Department. As a result, clarification was sought as to directions given by NCLT which mandated JSW to take "*approval*" from Income Tax Department.

NCLT clarification- NCLT clarified that an opportunity should be given to Income-tax Department by way of obtaining **approval** as the Income Tax Department was not given an opportunity of being heard during proceedings.

Condition C - Claims of subsidiaries etc.
Argument by JSW- As proposed in resolution plan [Ref- CL. IX(4)] the reliefs towards prior claims, indemnities guarantees, credit comfort given by CD in relation to any of its subsidiary, associate and joint venture company should have stand unconditionally withdrawn for no consideration. However, NCLT *vide* its order provided such relief only to "JSW Vallabh Tinplate Private Limited". Hence the clarification was sought by JSW in order to extinguish claims of and indemnities given to other subsidiaries, joint ventures etc. of CD.

NCLT clarification- NCLT could adjudicate matters only in relation to stakeholders who are participants of CIRP process. Further NCLT felt that Cl. IX(4) had been couched in very wide terms which covered parties over whom present tribunal had no jurisdiction and obligations relating to parties of which tribunal had no knowledge. Hence, NCLT was not inclined to provide relief asked by JSW.

Arguments
JSW thereafter filed appeal in NCLAT against NCLT, New Delhi order dated April, 16, 2019 for aforementioned conditions imposed by NCLT.

Held

- In case of 'right to receivables' NCLAT stated that *"the appellant rightly suggested that any amount receivable by the company, being any asset of the Company shall continue to remain with the Company upon implementation of the Resolution Plan… the Resolution plan makes the debt payable to any stakeholders/ Creditors clear and no stakeholder including creditor can claim any dues from earlier period thereafter."*
- Reliance was also placed on the **SC ruling in Essar Steel** wherein it was stated that if a successful resolution applicant faces "undecided" claims after approval

of resolution plan it would *"amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor."*

- As regards the issue of "carry forward of losses" of the CD, NCLAT observed that notice was given to Income Tax Authority and no reply was filed or no objection was raised by said authority. NCLAT thereafter stated that guidance would be extracted from the provisions in the Income-tax Act 1961 and the Rules and Regulations framed thereunder. *Hence if a successful resolution applicant is entitled to carry forward losses under section 79 of the Income-tax Act it may claim such benefit before the appropriate authority.*

- Further as regards the prior claims, privileges etc. of 'subsidiaries', 'associates' and 'joint ventures' Companies of the CD, such claims, privileges etc. shall stands extinguished after the approval of the resolution plan.

- Thus, NCLAT approved the resolution plan submitted by JSW and set aside the remaining order of NCLT with regards to 'right to receivables', 'carry forward of losses' and 'claims of subsidiaries, associate companies and joint ventures of the CD'.

Readers can refer orders/judgment passed by NCLT and NCLAT as cited below-

In the matter of Vardhman Industries Limited and Ashok Kumar Gulla and Jitender Singh Nimi and Punjab National Bank CP- IB-303/(ND)/2017	NCLT, New Delhi Bench-III (Order dated December 19, 2019)
In the matter of Vardhman Industries Limited and JSW Steel Limited CP- IB-303/(ND)/2017	NCLT New Delhi Bench-III (Order dated April 16, 2019)
In the matter of ***JSW Steel Limited vs. Ashok Kumar Gulla & Ors.*** Company Appeal (AT) (Insolvency) No. 467 of 2019	NCLAT (Judgement dated December 4, 2019)

79. Notwithstanding anything contained in this Chapter, where a change in share-holding has taken place in a previous year,–

(a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred;

(b) in the case of a company, not being a company in which the public are substantially interested but being an eligible start-up as referred to in section 80-IAC, the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if, all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred,–

(i) continue to hold those shares on the last day of such previous year; and

(ii) such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated:

Provided that nothing contained in this section shall apply to a case where a change in the said voting power and shareholding takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift:

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company:

Provided also that nothing contained in this section shall apply to a company where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016 (31 of 2016), after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

3. SEBI

Ruling of Securities Appellate Tribunal– Insider Trading

In the matter of ***Mr. Abhijit Rajan vs. Securities and Exchange Board of India (SAT Order dt. 8th November 2019)***

Facts of The case

Gammon Infrastructure Projects Limited ("GIPL") was an infrastructural project development company. GIPL was awarded a road project by National Highway Authority of India ("NHAI") in Andhra Pradesh. Cost of same was ₹ 1,648 crore. GIPL set up a Special Purpose Vehicle ("SPV") for this project.

Similarly another company Simplex Infrastructure Limited ("Simplex") was awarded a road project by NHAI in Jharkhand and West Bengal. Cost of same was ₹ 940 crore. Simplex formed an

SPV for this project. GIPL and Simplex had on 26th April 2012 entered into two shareholders agreement ("SHA") under which they agreed to invest 49% equity investment in the projects allotted to each other.

Board of Directors of GIPL in its meeting held on 9th August 2013 authorised to cancel SHA, which actually got signed & terminated on 30th September 2013. Mr. Abhijit Rajan ("Appellant"), the then Chairman and Managing Director of GIPL sold ₹ 1,43,81,246 shares on 22nd August 2013 for ₹ 8.28 crore.

SEBI during its investigation found that on the date of sale of shares (i.e., 22nd August 2013) by the appellant he had unpublished information with him of cancellation of SHA.

Chronology of events for above case is as under:

Board of Directors of GIPL authorised cancellation of shareholders agreement with Simplex	9th August 2013
Sale of Shares by Appellant	22nd August 2013
Simplex and GIPL signed termination agreement	30th August 2013
Announcement of cancellation of two shareholders agreement to stock exchange	3rd September 2013

Charge

Appellant was held guilty by SEBI of Insider Trading and was asked to disgorge an amount of ₹ 1.09 crore, which was already deposited in escrow account.

Arguments made by Appellant

(1) **Information in question is not material to impact the price of securities of GIPL**

a. SEBI should be able to prove that information would have an adverse impact on price of security. SEBI has simply assumed that termination of SHA involved significant changes in the policies, plans or operation of the company and therefore it would be UPSI.

b. The termination of SHA had two consequences (i) GIPL acquired exclusive control on the larger part of the contract worth ₹ 1,640 crore and (ii) exited from relatively small project of ₹ 940 crore in which GIPL had invested only ₹ 4.9 crore representing less than 0.05% of GIPL's order book value at end of August, 2013 and only around 0.7% of the turnover of the financial year ending March 31, 2013. This cannot be termed as material exposure. SEBI argued that termination of SHA would have an impact if 3.1% in the order book value of GIPL.

c. GIPL itself did not regard the information as price sensitive and, therefore, trading window was not closed. Green signal was sought from the Compliance Officer before the sale of the shares and the same was granted.

(2) **SEBI erred in taking closing price**

Appellant further explained that though the termination of SHA was disclosed to stock exchanges on 3rd September, 2013 in the noon, the respondent SEBI for its own calculation purpose took into consideration the weighted average closing price as on September 4th, 2013 as ₹6.56. In fact the weighted average closing price of the shares as on 3rd September, 2013 ought to have been taken into consideration. On September 3, 2013 immediately after disclosure of termination of SHA the price movement in GIPL showed a small increase of 0.10 paise and on 4th September, 2013 it decreased by 0.30 paise. Appellant contended that SEBI deliberately took September 4, 2013 closing price when price were around 30% lower than closing price as on 3rd September 2013. SEBI argued that price of shares actually decreased on disclosure is not material.

(3) **Sale of shares was for the purpose of infusing funds in GIPL pursuant to Corporate Debt Restructuring Scheme (CDR)**

During the relevant period GIPL was under financial stress and was facing the prospect of liquidation under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). In the master restructuring agreement the promoters' contribution was necessary and, therefore, the appellant sold the shares and the amount was deposited in the account of CDR scheme. Appellant had also raised ₹ 5.15 crore by selling his other properties and all this money was deposited in the account of CDR scheme. Infusion of funds in CDR scheme was going on since June 2013. Amount of ₹ 46.50 crore was deposited till 17-9-2013.

Held

(1) SAT held that the information of cancellation of SHA with Simplex was not price sensitive information. The record shows that GIPL had invested only ₹ 4.9 crore in the Simplex project in the said financial year. It represented only 0.05% of the GIPL's order book value at the end of August, 2013 and only 0.7% of its turnover for the financial year ended March 2013. SAT further held that Adjudicating Officer has calculated change in order book value without assessing whether change is positive or negative. Considering the minor proportion of the transaction to the turnover of GIPL, SAT held that cancellation of SHA cannot be termed as price sensitive information.

(2) SAT further held that even if it is assumed that the information was price sensitive information, still the appellant cannot be blamed of insider trading for the reasons that he did not trade "on the basis of the information". Appellant was able to show his dire need to infuse fund in the entity under the master restructuring agreement to implement a CDR package.

(3) Information was disclosed to the BSE and NSE on September 3, 2013 at 1.05 p.m. and 2.40 p.m. respectively i.e., much before the closure of the market. There is no reason forwarded in the impugned order as to why the last traded price of September 3, 2013 is not taken into consideration by respondent SEBI. Thus SAT noted that there was no adverse effect on the price of shares. For all these reasons SAT noted that the Adjudication order of SEBI cannot be sustained.

Readers can refer orders as cited below

1. ***Rajiv Gandhi & Ors vs. Securities and Exchange Board of India (SAT Order dt. 9-5-2008)***

2. ***Gujarat NRE Mineral Resources Ltd vs. SEBI (SAT Order dt. 18-11-2011)***

3. ***Mrs. Chandrakala vs. SEBI (SAT Order dt. 31-1-2012)***

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FEMA – Update and Analysis

CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

In this article, we have discussed recent amendments made in FEMA through Rules, Regulations, Notifications and AP DIR Series Circulars. In addition to it, few selected recent compounding orders issued by RBI are also discussed

Changes Notified by the Central Government (Ministry of Finance)

FEM (Non-debt Instruments) Rules, 2019 dated 17/10/2019

Government of India through Department for Promotion of Industry and Internal Trade "DPIIT" (earlier Department of Industrial Policy and Promotion "DIPP") notifies the industrial policy of the Government of India to direct investment into desired channels of industrial activity. The RBI was empowered to frame regulations for channelling foreign investment in accordance with the industrial policy in consultation with the GOI.

Vide Finance Act No. 2 of 2015, GOI assumed the powers to notify all capital account regulations except powers relating to Debt Instruments. It took GOI nearly four and a half years after the passage of the Finance Act 2015 (20 of 2015), when on 15th October 2019, the Ministry of Finance, Government of India, notified the provisions of Sections 139, 143 and 144 of the Finance Act, 2015 (the "**Notified Sections**") amending certain clauses of section 6 of the Foreign Exchange Management Act, 1999.

The Notified Sections have modified the powers of the Central Government *vis-à-vis* that of the Reserve Bank of India ("**RBI**") with respect to regulating capital account transactions. The Notified Sections provide that the Central Government may, in consultation with the RBI, frame rules for regulating capital account transactions not involving debt instruments. Similarly, the Notified Sections also provides that the RBI may, in consultation with the Central Government, frame rules for regulating transactions involving debt instruments. However, Central Government is empowered to notify the classes of debt instruments. Therefore, the amendments limit the powers of the RBI to framing rules for regulating transactions involving notified debt instruments, in consultation with the Central Government and other operational aspects of FEMA.

Following the notification of amended sections, GOI has issued notification No. S.O. 3732 (E) on

17th October 2019 which superseded following two Notifications issued by the RBI

- ***Notification No. FEMA 20(R)*** : Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017; and

- ***Notification No. FEMA 21(R)*** : Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 and notified new Foreign Exchange Management (Non-debt Instruments) Rules, 2019 to deal with the subject matter of the above two superseded Notifications.

Impact of the changes in FEM (Non-Debt Instruments) Rules, 2019

- Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 ("**TISPRO Regulations**") and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, stand repealed with effect from 17th October 2019.

- In place of the Repealed Regulations, the Central Government has notified the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**Non-Debt Instruments Rules**"). The Central Government has also separately issued a notification on 15th October 2019 setting out the instruments that are "debt instruments" and "non-debt instruments" (the "**Relevant Notification**").

- The regulations relating to the Acquisition and Transfer of Immovable property in India have also been subsumed under FEM (Non-Debt instruments) Rules, 2019 (Chapter IX).

- **Equity Instruments:** The term "capital instruments" has been deleted and replaced with "equity instruments" throughout the NDI Rules.

- **Definition of NRO and NRE account** is absent under FEM (Non-debt Instruments) Rules, 2019. Therefore, the expression shall have the meaning respectively assigned to them in FEM (Deposits) Regulations, 2016.

- **Definition of Sectoral Cap** in the FEM (Non-debt Instruments) Rules, 2019 dated 17-10-2019 read as: "sectoral cap" means the maximum investment including both foreign investment on a repatriation basis by persons resident outside India in equity and **debt instruments** of a company or the capital of a LLP, as the case may be, and indirect foreign investment, unless provided otherwise. This shall be the composite limit for the Indian investee entity. **However, the word 'debt instruments' has now been removed from the definition of 'sectoral cap' *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.**

- **Debt and Non-Debt Instruments:** The **clear distinction has been made between debt and non-debt instruments** by the amendments to FEMA and the rules and regulations notified pursuant to these amendments. All other instruments which are not specified shall be deemed as debt.

- **Non-debt instruments are defined to mean:** (i) all investments in equity instruments in incorporated entities: public, private, listed and unlisted; (ii) capital participation in LLP; (iii) all instruments of investment recognized in the extant foreign direct investment policy notified from time to time (FDI Policy); (iv) investment in units of Alternative Investment Funds (AIFs), Real Estate Investment Trust

(REITs) and Infrastructure Investment Trusts (InvIts); (v) investment in units of mutual funds or Exchange-Traded Fund (ETFs) which invest more than 50% in equity; (vi) junior-most layer (i.e. equity tranche) of securitisation structure; acquisition, sale or dealing directly in immovable property; (viii) contribution to trusts; and (ix) depository receipts issued against equity instruments.

Debt instruments are defined to mean all instruments other than non-debt instruments.

- **Hybrid Instruments:** A definition of “hybrid instruments” has been introduced to mean hybrid instruments such as optionally or partially convertible preference shares or debentures and other such instruments as specified by the Central Government, which can be issued by an Indian company or trust to a person resident outside India.

  However, the expression "hybrid instruments" has not been used in the Non-Debt Instruments Rules. Therefore, intention of introducing the definition is not very clear. It appears that GOI has retained flexibility and regulatory power with itself to classify instruments such as optionally or partially convertible preference shares or debentures and other such instruments as it deems fit as Hybrid Instruments to potentially provide more options to select foreign investors or allow such investors the choice of instruments with the intention to exempt such specified instruments from ECB Guidelines. However, one will have to wait for further clarification from the Government on this issue.

- **Investment Vehicle:** The term “investment vehicle” initially i**ncluded mutual funds that invest more than 50% in Equity Instruments** and are governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (Mutual Funds Regulations).

  However, the mutual funds have now been omitted from the definition of ‘Investment Vehicle’ *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.

- The TISPRO Regulations required that the **price/conversion formul**a of the convertible instrument should be determined upfront at the time of issue of the instrument. It further provided that the price at the time of conversion should not in any case be lower than the fair value worked out at the time of issuance of such instruments. The Non-Debt Instruments Rules had dropped this requirement.

  However, the explanation relating to price/conversion formula has now been inserted *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.

- **Definition of Foreign Portfolio Investment** in TISPRO regulations contained an explanation that the 10 per cent limit for foreign portfolio investors shall be applicable to each foreign portfolio investor or an investor group as referred to in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

  However, the said explanation has been removed in FEM (Non-debt Instruments) Rules, 2019.

- **Definition of Listed Indian Company:**

  o ***TISPRO Regulation:*** Listed Indian Company means an Indian company which has any of its c***apital instruments listed on a recognized***

stock exchange in India and the expression 'Unlisted Indian Company' shall be construed accordingly.

- o ***FEM (Non-Debt Instruments) Rules:*** Listed Indian Company means an Indian company which has any of its ***equity instruments or debt instruments listed on a recognised stock exchange*** in India and the expression "unlisted Indian company" shall be construed accordingly.

Thus due to this amendment, if only a debt instrument(s) of any company is listed on a recognised stock exchange then also such company would be treated as a listed Indian company.

- The TISPRO regulation authorized RBI to permit a PROI to make any investment in India subject to such conditions as may be prescribed. However, in Rule 3 of FEM (Non-Debt Instruments) Rules, the **RBI now in consultation of Central Government** may permit a PROI to make investment in India subject to such condition as may be prescribed.

- Rule 6 of FEM (Non-Debt Instruments) Rules permits **Investment by a PROI. Investment has been defined in rule 2(ac)** to mean to subscribe, acquire, hold or transfer any security or unit issued by a person resident in India. Investment shall also include to acquire, hold or transfer depository receipts issued outside India, the underlying of which is a security issued by a person resident in India. For the purpose of LLP, investment shall mean capital contribution or acquisition or transfer of profit shares.

- Rule 9(4) of FEM (Non-Debt Instruments) Rules read as **"A person resident in India** holding equity instruments or units of an Indian company **on a non-repatriation basis** may transfer the same to a person resident outside India by way of gift with the prior approval of the Reserve Bank…."

  However, the words 'on a non-repatriation basis has been removed *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.

- **Rule 11(1) and explanation** appended thereto of FEM (Non-Debt Instruments) Rules has been **deleted** *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.

- **Rule 30(b)** of FEM (Non-Debt Instruments) Rules reads as "…..to secure an external commercial borrowing availed under the provisions of the **Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000."**

  Reference to erstwhile Notification No. FEMA 3 has been given and not the FEM (Borrowing & Lending) Regulations, 2018 dated 17/12/2018.

- WOS set up in India by a non-resident entity is permitted to issue equity instruments to the said non-resident entity against pre-incorporation/ **pre-operative expenses** in TISPRO regulation as well as FEM (non-debt instruments) rules. However, under the new rules, the WOS needs to issue equity instrument to the non-resident entity **within one year from the date of incorporation** and report to RBI within 30 days from the date of issue. **(Rule 1(c) of Schedule I of FEM (Non-Debt Instruments) Rules, 2019).**

- Heading of Regulation 15 of TISPRO regulation reads as **Prohibited activities**

for investment by a PROI whereas corresponding heading of Rule 2 of Schedule I of FEM (Non-Debt Instruments) Rules, 2019 reads as **"Sectors Prohibited for FDI".**

Does that mean that no sectors are prohibited for foreign investment in LLP? It seems to be an inadvertent error in drafting of the rules.

- Certain amendments made to the sectoral policy *vide* Press Notes but which were not incorporated in FEM (Non-Debt Instruments) Rules, 2019 have now been incorporated *vide* FEM (Non-debt Instruments) (Amendment) Rules, 2019 dated 05/12/2019.

- **Foreign Portfolio Investors ("FPI")**

  – ***Caps on aggregate FPI investment***

    With effect from 1st April 2020, the default aggregate FPI limits in an Indian company is the applicable sectoral cap as laid out in Schedule I of the Non-Debt Instruments Rules. The TISPRO Regulations had capped the aggregate FPI limits to 24%, with the company being provided the option of enhancing the limits to the applicable sectoral cap.

    In case an Indian company wants to reduce the FPI limits to a lower threshold of 24%, 49% or 74%, it is allowed to do so before 31st March 2020. Further, once the limits are enhanced, the Indian company cannot reduce the limits.

    The above changes are applicable to sectors where FDI is not prohibited. In sectors where FDI is prohibited, the aggregate FPI limits is capped at 24% of the company's paid-up equity capital on a fully diluted basis or such same sectoral cap percentage of paid-up value of each series of debentures or preference shares or share warrants.

    An FPI has been provided five trading days from the date of settlement of the trades to divest its holdings in case the applicable FPI ceiling limit is breached. Failure to do so would result in the entire FPI limits being classified as FDI, and the relevant FPI investor is no longer allowed to make further investments under the FPI route.

  – ***Investments in Mutual Funds & Investment Vehicles by FPIs***

    An FPI may purchase units of domestic mutual funds or Category III Alternative Investment Fund or offshore fund for which no objection is issued in accordance with the SEBI (Mutual Fund) Regulations, 1996, which in turn invest more than 50 per cent in equity instruments on repatriation basis subject to the terms and conditions specified by the Securities and Exchange Board of India ("**SEBI**") and the RBI.

An FPI may purchase units of real estate investment trusts and infrastructure investment trusts on repatriation basis subject to the terms and conditions specified by SEBI.

- **Table providing comparison of routes for foreign investment both under TISPRO Regulations and under FEM (Non-Debt Instruments) Rules, 2019 are as under:**

Investment Type	*Old TISPRO Regulation*	*New Rules*
Foreign Direct Investment (FDI)	Schedule 1	Rule 6 - Chapter III
Portfolio Investment by FPIs	Schedule 2	Rule 10 - Chapter IV
Portfolio Investment by NRIs/OCIs	Schedule 3	Rule 12 - Chapter V
Investment on Non-repatriation basis	Schedule 4	Rule 12 - Chapter V
Purchase/ sale of other than capital instruments by non-residents	Schedule 5	Rule 14 - Chapter VI Notification No. - 396
Investment in Limited Liability Partnership (LLP)	Schedule 6	Rule 6 - Chapter III
Investment by Foreign Venture Capital Investor (FVCI)	Schedule 7	Rule 16 - Chapter VII
Investment by Non-residents in Investment Vehicle	Schedule 8	Rule 6 - Chapter III
Investment in Depository receipts by Non-residents	Schedule 9	Rule 6 - Chapter III
Issue of Indian Depository receipts (IDRs)	Schedule 10	Rule 10 & 12 - Chapter IV & V
General Provisions (Issue of Convertible Notes by an Indian Start-up company, Merger or Demerger or Amalgamation, Reporting Requirements, Downstream Investment)	Regulations 8, 9 and 14	Rules 18 to 23 - Chapter VIII

- **Changes Notified by the Reserve Bank of India**

  (Debt Instruments) Regulations, 2019 (FEMA 396): Consequent to the changes discussed above, the RBI notified new foreign exchange management (Debt Instruments) Regulations, 2019 *vide* FEMA 396/2019-RB dated 17/10/2019 and Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 ("**Reporting Regulations**") *vide* **FEMA 395/2019-RB dated 17/10/2019.**

Non-Debt Instruments Rules -Reporting of Foreign Investment Transactions (FEM 395): In exercise of the powers granted to it by the Notified Sections and the Non-Debt Instruments Rules which provides that the reporting requirements for any investment shall be as specified by the RBI, the RBI has framed the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 ("**Reporting Regulations**") *vide* **FEMA 395/2019-RB dated 17/10/2019.**

The Reporting Regulations provide regulatory guidance regarding the mode of payment and remittance of sale proceeds involving non-debt instruments and the reporting obligations related to the same. The Reporting Regulations are largely in line with the TISPRO Regulations.

However, Schedule III which deals with **Investment by NRI/ OCI on repatriation basis** states that **payment** for subscription to National Pension System **may be paid from NRO Account** apart from inward remittance from abroad/ NRE/FCNR(B) Account. It seems to be an inadvertent error while drafting the regulations.

- **Impact of the changes in FEM (Debt Instruments) Regulations, 2019 *vide* No. FEMA 396/2019-RB dated 17/10/2019**

  – As per Regulation 5(3) of FEM (Debt Instruments) Regulations, 2019, A PROI may enter into contract in **any Derivative transaction** subject to conditions laid down by RBI from time to time. In **TISPRO regulations,** PROI was permitted to enter into any contract in **interest rate derivative** subject to the prescribed conditions.

  – Regulation 1A and 1B of Schedule I to FEM (Debt Instruments) Regulations, 2019 permits a NRI/ OCI to purchase ETFs (Repatriation/ non-repatriation basis) which invests less than or equal to 50 per cent in equity.

  – TISPRO regulation had permitted NRI/ OCI to purchase units of money market mutual fund. However, the same has now been removed under FEM (Debt Instruments) Regulations, 2019.

  – FEM (Debt Instruments) Regulations, 2019 permits NRI/ OCI to purchase Listed non-convertible/ redeemable preference shares or debenture purchased only in terms of regulation 6 (merger/ demerger/ amalgamation of Indian companies) of these regulation.

(Comments: The amendments have brought in deep change in the framework of FEMA with the RBI assuming role of mere operational regulator except for drafting regulations for debt instruments in consultation with GOI. While the recent Non-Debt Instruments Rules notified by the GOI have per-se not dramatically altered current regulatory framework governing foreign investment, nevertheless it highlights the shift in the regulatory authority. The changes are designed with the objective of a streamlined approach between the RBI and the Central Government for regulating foreign investments to achieve the desired results.

Bringing hybrid instruments under the domain of Non-Debt Instruments could be seen as a major policy shift. The window of five days provided to FPI investors to divest their stakes to permissible levels of holding is a much-needed breather for investors who inadvertently breach the investment thresholds. The changes in rules for FPI investment in Mutual Funds have considerably expanded the universe of investment opportunities available to FPI investors making India a more attractive destination. Consolidation of reporting regulations governing remittance and other reporting in one regulation would be useful to the stakeholders and is a welcome change).

B. Updates through issuance of Notification

Notification No. FEMA 5(R)/(3)/2019-RB - FEM (Deposit) (Third amendment) Regulations, 2019 dated 13/11/2019 and A.P. (DIR Series) Circular No. 09 dated 22/11/2019: With a view to promote the usage of INR products by persons resident outside India, it has been decided, in consultation with the Government of India, to expand the scope of SNRR Account and also to rationalise certain other provisions for operation of the SNRR Account. Changes are as under:

- **In the Principal regulation, in Schedule 4 of FEM (Deposit) Regulations,**
- **For Paragraph 1, the following shall be substituted:**

"1. Any person resident outside India, having a business interest in India, may open Special Non-Resident Rupee Account (SNRR account) with an authorised dealer for the purpose of putting through *bona fide* transactions in rupees, not involving any violation of the provisions of the Act, rules and regulations made thereunder. The business interest, apart from generic business interest, shall include the following INR transactions, namely:–

i. Investments made in India in accordance with Foreign Exchange Management (Non-debt Instruments) Rules, 2019 dated October 17, 2019 and Foreign Exchange Management (Debt Instruments) Regulations, 2019 notified *vide* Notification No. FEMA 396/2019-RB dated October 17, 2019, as applicable, as amended from time to time;

ii. Import of goods and services in accordance with Section 5 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated May 3, 2000, *viz.*, Foreign Exchange Management (Current Account Transaction) Rules, 2000, as amended from time-to-time;

iii. Export of goods and services in accordance with Section 7 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated May 3, 2000, viz., Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time-to-time, and further read with FEMA Notification No. 23(R)/2015-RB dated January 12, 2016, as amended from time to time;

iv. Trade credit transactions and lending under External Commercial Borrowings (ECB) framework in accordance with Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, as amended from time-to-time; and

v. Business related transactions outside International Financial Service Centre (IFSC) by IFSC units at GIFT city like administrative expenses in INR outside IFSC, INR amount from sale of scrap, government incentives in INR, etc. The account will be maintained with bank in India (outside IFSC)."

- **For Paragraph 2, the following shall be substituted:**

  "2. The SNRR account shall carry the nomenclature of the specific business for which it is in operation. Indian bank may, at its discretion, maintain separate SNRR account for each category of transactions or a single SNRR account for a person resident outside India engaged in multiple categories of transactions provided it is able to identify/segregate and account them category-wise."

- **In Paragraph 3, 5 and 6, for the word 'should', the word 'shall' shall be substituted.**

- **For Paragraph 8, the following shall be substituted:**

  "8. The tenure of the SNRR account shall be concurrent to the tenure of the contract/period of operation/ the business of the account holder and in no case shall exceed seven years. Approval of the Reserve Bank shall be obtained in cases requiring renewal:

  Provided the restriction of seven years shall not be applicable to SNRR accounts opened for the purposes stated at sub-paragraphs i to v of paragraph 1 of this schedule."

- **For Paragraph 13, the following shall be substituted:**

  "13. The amount due/payable to non-resident nominee from the account of a deceased account holder, shall be credited to NRO/NRE account of the nominee with an authorised dealer/ authorised bank in India or by remittance through normal banking channels."

Corresponding changes are made in Notification No. FEMA 14(R)/(1)/2019-RB - FEM (Manner and Receipt of Payments) (Amendment) Regulations, 2019 dated 13/11/2019

Notification No. FEMA 23(R)/(2)/2019-RB - FEM (Exports of Goods and services) (Amendment) Regulations, 2019 dated 09/12/2019

- **After sub-regulation (e) of regulation 4, the following shall be inserted:**

  "(ea) re-export of leased aircraft/helicopter and/or engines/auxiliary power units (APUs) repossessed by overseas lessor and duly deregistered by the Directorate General of Civil Aviation (DGCA) on the request of Irrevocable Deregistration and Export Request Authorisation (IDERA) holder under 'Cape Town Convention' subject to permission by DGCA/Ministry of Civil Aviation for such export/s".

C. Updates through issuance of AP DIR Series Circular

A.P. (DIR Series) Circular No. 10 dated 22-11-2019

- **Paragraph 4 of A.P. (DIR Series) Circular No. 1 dated July 02, 2015 has been modified and now it reads as:**

  For the lot/lots cleared at the center/s which are duly notified under Customs Act, 1962/specified by the Central Board of Indirect Taxes & Customs, Department of Revenue, Ministry of Finance, Government of India for the above purpose, Bill of Entry shall be filed by the buyer. AD bank may permit such import payments after being satisfied with the *bona-fides* of the transaction. Further, AD bank shall also maintain a record of such transactions.

D. Analysis of few recent compounding orders issued by RBI

1) Foreign Exchange Management (Current Account Transactions) Rules, 2000

Not obtaining necessary prior approval from the Government of India (GoI) for making payments to overseas entities with respect to transponder hiring charges.

Applicant	Tata Communications Limited
Compounding Application Number	C.A. No. 4924/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 1,48,15,250/-
Date of order	18th October 2019
Facts of the case	The applicant had hired services of two foreign satellite service providers and had remitted transponder hiring charges by way of multiple remittances to the Satellite Service Providers through EEFC and non-EEFC accounts.
Contravention	As per rule 4 of Foreign Exchange Management (Current Account Transaction) Rules, 2000, no person shall draw foreign exchange for a transaction included in the Schedule II without prior approval from GoI. Further, as per Item No. 6(a) of Schedule II, any remittance towards hiring charges of transponder by TV channels shall require prior approval from GoI. Since in the present case the applicant had remitted the amount from applicant's non-EEFC account without the prior approval of the RBI. Thus, it was held that the applicant had contravened provisions of Foreign Exchange Management (Current Account Transaction) Rules, 2000. Payment for the same through EEFC account is permitted.

2) Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 and Master Direction No. 7/2015-16 on Liberalised Remittance Scheme

Remittance of excess amount under the Liberalised Remittance Scheme (LRS)

Applicant	Seba Bapu Moopan
Compounding Application Number	C.A. No. 4961/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 58,932/-
Date of order	14th October 2019

Facts of the case	The applicant, an Indian resident had remitted an amount of USD 2,71,480 under LRS during the FY 2017-18 which exceeded the prescribed limit of USD 2,50,000. The Bank had reportedly sought clarification from the applicant. The applicant claimed ignorance stating that she assumed that the LRS limit was not inclusive of ODI transactions and hence did not declare the transactions done for family maintenance in the cumulative position while remitting for ODI purpose. As the LRS transactions were monitored manually by the applicant's bank, control through PAN was not possible. The applicant has remitted back the excess amount of USD 21,480.
Contravention	As per regulation 4 of Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000, no person shall undertake or sell or draw foreign exchange to or from an authorised person for any capital account transaction provided that a resident individual may draw from an authorised person not exceeding USD 2,50,0000 per financial year for a capital account transaction. Since in the present case the applicant had remitted the amount which exceeded the limit of USD 2,50,000 without the prior RBI approval, applicant had contravened the above provision.

3) **Transfer or Issue of any foreign Security (Outbound Investment) (FEMA 120/2004-RB)**

Acquiring of foreign securities by way of gift from a person resident in India

Applicant	Ms. Pratibha Agrawal
Compounding Application Number	C.A. No. 4958/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 66,869/-
Date of order	11th November 2019
Facts of the case	The applicant is a resident individual and spouse of Shri Virendra Agrawal, a Senior Vice President - Finance in Sterlite Industries India Limited. Shri Virendra Agrawal was offered 8,000 shares of Vedanta Resources Plc to be issued in two tranches. Out of the 4,000 shares of the second tranche, Shri Agrawal gifted 3,000 shares to the applicant and accordingly, share certificates for these 3,000 shares were issued in the name of the applicant.

	Since in the present case the applicant had received shares of foreign company as a gift from a person resident in India, it resulted into contravention of provisions of regulation 22(1)(i) r.w. regulation 3 of FEMA 120/2004-RB.

4) **Export of Goods and Services (FEMA 23/2000-RB)**

Failure to export the goods within a period of one year from the date of receipt of advance

Applicant	H F Metal Art Private Limited
Compounding Application Number	C.A. No. 4939/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 10,32,998/-
Date of order	05th November 2019
Facts of the case	The applicant received certain export advances but was unable to make exports within the prescribed time limit. However, the applicant has adjusted the export advances against exports made during the period from August 2013 to June 2014 and as on date no advances are outstanding.
Selected Contravention	Failure to export goods within a period of one year from the date of receipt of advance payment: As per regulation 16 of Notification No. FEMA 23/2000-RB, an exporter should export the goods within 1 year from the date of receipt of advance payment. Since in the present case the applicant had failed to export the goods within the prescribed time period, it was held that the applicant had contravened provisions of FEMA 23/2000-RB.
Comments	Though Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 has been replaced by revised regulations; Regulation 15 of extant FEMA 23(R)/2015-RB dated 12/01/2016 corresponds to Regulation 16 of erstwhile FEMA 23/2000- RB dated 03/05/2000.

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CA Khurshed Pastakia

An Analysis of Report on Audit Quality Review for 2018-19

A major change over the previous years in the working of the Quality Review Board (QRB) during 2018-19 was a clarification received by QRB from the Ministry of Corporate Affairs (MCA) that[1] companies/bodies corporate covered by NFRA should no longer be reviewed by QRB unless specifically referred to it by NFRA.

The 2018-19 QRB review has therefore shifted focus from large listed companies that it was used to reviewing so far, to private limited companies, unlisted public companies (below NFRA thresholds), and other entities not covered under NFRA. It also completed reviews of NFRA-covered entities that were work-in-progress when the MCA clarification was received. Going forward, the focus of QRB inspections will shift entirely to smaller companies and, hopefully, the number of audit firms and files reviewed will also be larger than it has been so far because it takes far less time to review the audit of a small company as compared to that of a larger and more complex one.

Of the 64 files of 51 audit firms reviewed, only 33% were found to be 'generally acceptable', as many as 66% were classified as 'requiring improvements', and 1% 'requiring significant improvements'. So, basically, 2/3rds of the audits performed out of the selected sample were found to be of poor quality. This statistic highlights the alarming failure of audit quality across the spectrum of audit firms in India and is not a happy thought for us, given the significantly heightened regulatory oversight and enforcement actions hovering above our profession in recent times.

Globally, some of the key audit failures result from:

- A failure to sufficiently challenge management
- A failure to exercise due professional skepticism
- Improper audit sampling and error evaluation
- A failure to properly audit accounting estimates, including fair value measurements

1. In view of S. 132(2) of the Companies Act, 2013 read with Rule 9(4) of NFRA Rules, 2018.

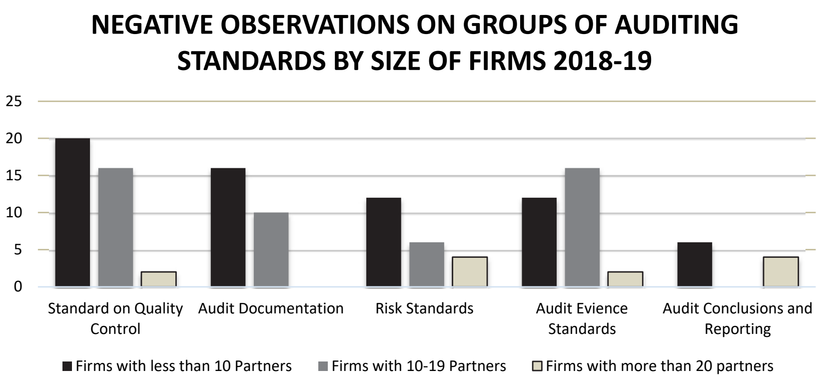
- A failure to properly test internal controls
- Inadequacy of financial statements presentation and disclosures
- A failure to properly audit revenue recognition

While this by no means is a comprehensive list, it will be observed that the last four specific audit failures are directly responsible for a majority of accounting frauds, and they are primarily caused by the first three auditor attitudes and practices.

For future QRB Reports to be more meaningful, they ought to focus more on the failures in the actual auditing of accounting estimates, revenue recognition and internal controls than merely commenting on the lack of proper documentation in these vital and fraud-prone areas.

As per this QRB Report for 2018-19, the percentage of reviewed firms having negative observations on groups of standards on auditing by size of firms is:

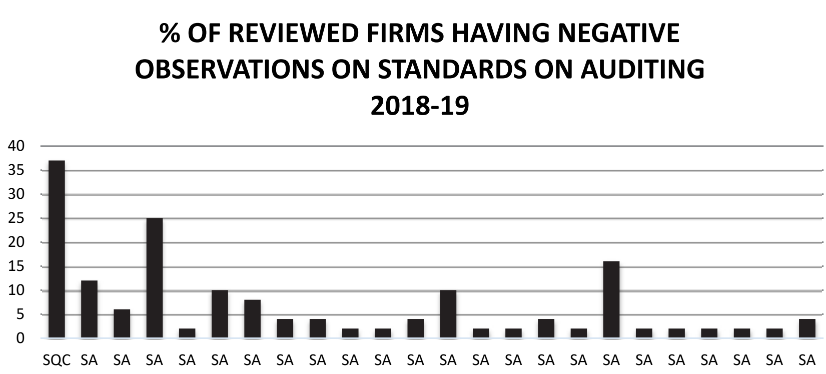
Figure 1



A quick look at the above chart shows that firms with less than 10 partners lead the charge of negative observations in almost all the five areas, while those with more than 20 partners have the fewest negative comments. In other words, smaller audit firms clearly have the poorest audit quality.

A detailed auditing **standard-wise** break-up of negative observations has been:

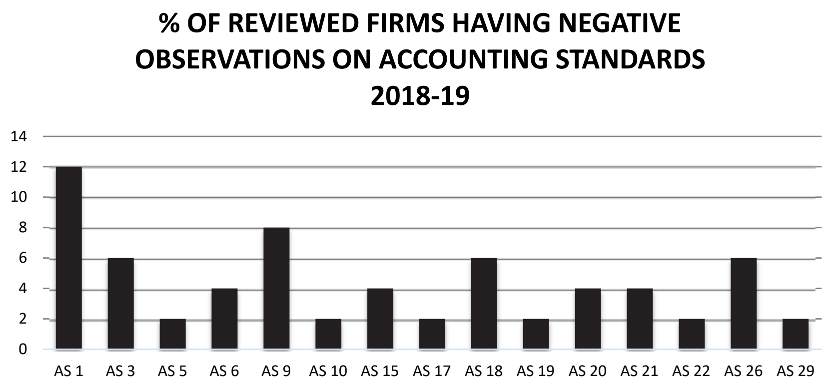
Figure 2



Among the auditing standards that are least followed are SQC 1 – Standard on Quality Control; SA 230 – Audit Documentation; SA 580 – Written Representations; SA 210 – Agreeing the terms of Audit Engagements; SA 300 – Planning an Audit of Financial Statements; SA 505 – External Confirmations; and SA 315 – Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment. It will be an endeavour to provide some thoughts on compliance with these standards in the paragraphs below.

A detailed **accounting standard-wise**[2] break-up of negative observations has been:

Figure 3



Among the accounting standards that were found to have the most negative observations were: AS 1 – Disclosure of Accounting Policies; AS 9 – Revenue Recognition; AS 3 – Cash Flow Statements; AS 18 – Related Party Disclosures; and AS 26 – Intangible Assets.

Most of the negative observations in the QRB's 2018-19 report are also similar to those in the QRB's 2017-18 report. This indicates that not much has improved over the last one year in the quality of auditing in India. The Institute has developed video lectures for guiding members on the implementation of SAs. These video lectures are to be found on the "Digital Learning Hub" on the Institute's website https://learning.icai.org/e learning and should be useful even if they cannot replace the value of detailed reading and study of the standards themselves.

AUDITING STANDARD DEFICIENCIES

SQC 1 AND AUDIT DOCUMENTATION

Non-compliance with SQC 1 and Audit Documentation remain, by and large, the most prominent among auditing standards, implying that the profession is not trying hard enough to meet the mandatory quality control or documentation requirements of the Institute. It may be noticed that this is peculiar to India and is not an aberration observed globally. One reason for that is the unique size, nature and attitude of professional practice firms performing audits in our country as compared to elsewhere. Figure 1 above reveals the big deviation in compliance in these two areas between firms having less than 20 partners and firms having more than 20 partners.

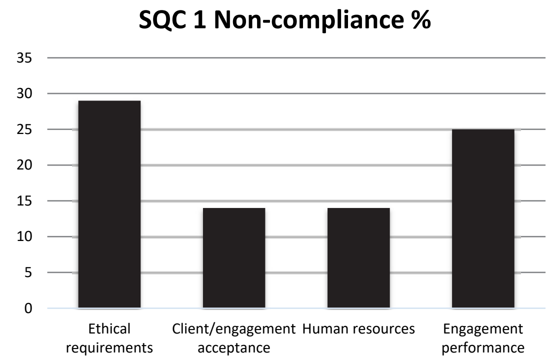
2. For some reason the QRB Report 2018-19 has not mentioned compliance or otherwise with Indian Accounting Standards (Ind-AS) which should be applicable to the larger entities reviewed.

The QRB report lists non-compliance in practically every head of SQC 1 and audit documentation, and not in some specific areas that one could focus upon for improvement.

When a firm practices audits in an environment that comprehensively fails the test of quality control, it exposes itself to the risk of fraud passing through its vigilance. In that situation, it could face regulatory scrutiny where, due to a lack of audit documentation, it would find itself unable to convince the inspectors and enforcement agencies that it had indeed done what needed to be done to fulfil the requirements of the auditing standards and was not professionally negligent.

The QRB report states: "If any audit document has not been prepared properly for an important matter, this is not simply a deficiency of documentation, but in many cases, it could imply that the necessary audit procedures have not been implemented. Furthermore, it should also be noted that a lack of proper audit documentation usually implies that the audit firm also has deficiencies in engagement quality control review, periodic inspection, education, training (review of guidance and supervision of audit assistants and audit documents in particular) and/or other areas, not just insufficiency in the knowledge and capabilities of the engagement team."

There are six areas where an audit firm is required to establish and maintain quality controls under SQC 1: (i) Leadership responsibilities for quality within the firm; (ii) Ethical requirements; (iii) Acceptance and continuance of client relationships and engagements: (iv) Human resources; (v) Engagement performance; and (vi) Monitoring. Of these, the QRB focused upon (ii), (iii), (iv) and (v) and found the following extent of discrepancies:



Ethical requirements

Ethics in practice is the foundation of our profession's reputation. Ethics is a human quality but under SQC 1 it essentially means compliance with the Institute's Code of Ethics and Auditor Independence. SQC 1 requires audit firms to establish and put into practice an Independence Manual (a draft of which is provided in the publication "Implementation Guide to SQC 1").

The report plays upon the documentation aspects of Ethical Requirements but, while documentation is important from the viewpoint of examinable evidence, the basic question is of compliance with ethics in our real professional life. As auditors it becomes our duty to dispel, by our conduct, the public perception that some auditors are "bendable" or can be "pressurised".

Client/engagement acceptance and continuance

The quality of our clients and engagements define our practice and, consequently, our audit quality. If our clients are of doubtful integrity in their business practices, they are unlikely to be honest even with us. Signing financial statements or other reports and certificates of such clients is fraught with professional danger that could entangle us in even criminal proceedings. It is not worth taking up such clients or their engagements, even if they offer an attractive fee.

Human resources

A professional firm's biggest asset is its people. A firm needs to "invest" in high-quality people and ensure that they "maintain" their quality. This requires ensuring that they constantly keep their knowledge and skills up to date, given the rapid changes in accounting and auditing standards, government rules and regulations, and information technology, where knowledge gets outdated and skills become obsolete faster than one would like. Besides, it is also important that the audit teams are kept highly motivated and are passionate about doing audits.

The fact that the QRB report points to a lack of evidence of processes set up to skill audit staff, evaluate their performance formally, their career development, etc., actually reflects that these human resource aspects are actually not being fully addressed by audit firms.

Engagement performance

Of all aspects of audit quality, how we perform audit engagements is the most crucial. It is an unfortunate fact that across our country auditors have largely failed to perform audits in accordance with the standards on auditing. There may be several reasons for this, but the most often-quoted reason is that compliance with standards is not possible because the audit fees we get are unremunerative. The reason for unremunerative fees is our own propensity to undercut each other to levels that are completely unsustainable. If the profession stands united and demands fees commensurate with the quality of services that we render, the clients would not be able to divide and rule us, the way they are currently doing. This is the root cause and the most urgent issue that needs to be addressed, collectively by the Institute and individually by each one of us. If there is no "will" to comply with standards, no amount of technical detailing of what needs to be done is going to serve any purpose.

The areas that the QRB Review has highlighted are: consultation, EQCR (Engagement Quality Control Review), and engagement documentation. There are, admittedly, difficulties for very small sole proprietorship firms to implement consultation and EQCR. However, such firms could seek consultation from chartered accountants from other firms on technical matters and document the results thereof. The same procedure could be followed for EQCR. However, larger firms having two or more partners should establish these processes in-house. Audit documentation is a very major issue that, as was mentioned in the paragraph above, is deliberately not followed because of the time-cost involved and not because of any lack of knowledge or ability on part of the audit firms. Also, it is wrongly believed by some practitioners that if one does not document a procedure that was not at all performed, they could simply say that they performed the procedure but merely failed to document it. Such fanciful arguments do not work. It has been established consistently and repeatedly that inspectors, regulatory enforcement authorities and courts of law consider that "what is not documented is not done."

Root cause analysis by QRB

The QRB Report has documented root cause analysis for SQC 1 deficiencies, summarised as under:

- No comprehensive SQC document on various elements of quality control, not backed by evidence supporting implementation;
- CEO/MP (managing partner) did not fully recognise how audit environment has changed and did not understand requited QC system to be implemented;
- CEO/MP did not take action to enhance partners' awareness, capabilities and competence to improve audit quality and perform audit engagements;

- Failure to allocate sufficient resources, enough time, and experienced, competent engagement team (including EQCR);
- Failure to implement policies and procedures for acceptance and continuance of engagements;
- Failure to test independence on the engagements ensuring independence at all times;
- Failure to have learning calendar and ensuring that firm's partners and employees are complying with ICAI rules;
- Failure to implement elements of monitoring activity.

The QRB Report has documented root cause analysis for Audit Documentation deficiencies, summarised as under:

- Personnel did not fully recognise the importance of audit documentation;
- ET (engagement team) did not fully verify whether audit documentation was prepared;
- Engagement partner did not review audit documentation nor provide sufficient attention to less experienced audit practitioners despite they were in majority due to frequent turnover;
- Engagement partner did not conduct sufficient review of audit documentation;
- Engagement partner did not have proper EQCR in place;
- Audit firm did not have in place education/training system with due consideration of experience of audit practitioners, scope of their audit engagements, changes in SAs and other relevant factors.

SA 580 WRITTEN REPRESENTATIONS

A lack of audit documentation actually includes a lack of written representations. However, the QRB has categorised this deficiency separately, probably to highlight it. The ET must obtain certain written assurances from the client to safeguard itself, such as whether all transactions have been recorded in the books, significant assumptions made by management and their rationale, reasons for making/not making certain provisions, the accounting framework used by management to prepare the accounts, etc. These are usually to be found in a management representation letter drafted by the auditor and signed by the client.

During the course of audit, the auditor seeks certain information from the client. Mostly, this information is initially provided orally. But where such information is being relied upon by the auditor to form his judgment, he must obtain that information in writing from a duly authorised client executive, and then subject that to the test of corroboration. This also forms part of written representations.

It must be realised that when an auditor has to defend himself and his work, he needs evidence to establish his case. Such evidence is only the contents of his audit file.

SA 210 AGREEING TO THE TERMS OF THE AUDIT ENGAGEMENT

The relationship between a client and an auditor is a contractual relationship. An engagement letter signed by both parties, laying out the scope of work and expectations from both sides is the contract. Without a written contract, how would an auditor safeguard himself in the event of any dispute with the client, or prove in a court of law what the management's responsibilities were under the agreement and what was the scope of his work?

Sample engagement letter that can easily be tailored to specific needs of an engagement are available in several publications of the Institute.

SA 300 – PLANNING THE AUDIT OF FINANCIAL STATEMENTS

Actually, it is not just compliance with SA 300 that is a deficiency but the whole set of standards on planning namely, SAs 300, 315, 320 and 330. These set of standards are the heart of a "risk-based audit".

Earlier when engagements were relatively small, an auditor used to perform a 100% audit by checking all the transactions. As size of engagements began to grow larger, auditors began to check transactions selectively, based on the potential risk that a class of transactions carried. This selective checking (or test check) has been accepted by professional bodies and courts of law. However, the selection that an auditor makes cannot be arbitrary or based on his whims and fancies. There has to be a well thought out method in making that selection that involves planning an audit; assessing risk at the account balance and financial statement levels; determining materiality; evaluating the design, implementation and operating effectiveness of internal controls; and laying out the course of audit procedures that address the identified risks within the bounds of materiality.

If the audit file contains no documentation to establish how the auditor concluded on the nature, scope and extent of his audit procedures, it would imply that the auditor did not apply his mind to that process at all. The integrity with which he selected transactions to audit could be effectively challenged, and that could have quite serious implications for the auditor.

One is sure that all auditors would be planning their audits one way or another, depending upon the size and complexity of the engagement, and there would inevitably be a method that they follow in making a selection of what and how to audit. However, if this decision process is not documented, it cannot be established before a third-party.

SA 505 – EXTERNAL CONFIRMATIONS

When a client's assets or liabilities are with third parties, a powerful piece of evidence is a direct confirmation obtained by the auditor independently from those third-parties as to the truthfulness of assertions that the client has made about them in the financial statements.

In the Indian context, it is admittedly difficult for an auditor to obtain direct confirmations from third parties without unrelenting pursuit but, just because it is a difficult audit procedure to follow, there can be no justification for auditors not following it. For example, if 70% of receivables shown as assets in the balance sheet are not supported by direct confirmations, the first impression an outsider will get is that the auditor did not obtain any evidence to audit 70% of the receivables. The auditor may have performed alternative procedures to vouch the said assertion, but all alternative procedures in such cases are relatively weak procedures that do not have the evidential strength of direct confirmations. Besides, the audit file might not even contain sufficient appropriate audit documentation of why direct confirmations could not be obtained (e.g. evidence of the extent of effort made) or of the alternate procedures followed, and why the auditor considered them to be appropriate substitute procedures.

REVIEW OF AUDIT OF INTERNAL CONTROLS

The QRB, in my opinion, does not appear to have done sufficient work on reviewing how auditors have certified companies' internal control over financial reporting. This is an area that should have brought out a lot of deficiencies, given the general lack of knowledge and appreciation that exists among practitioners as regards evaluating and testing of internal controls of companies where they report upon those controls.

It should be noted that almost all frauds across the world have their roots in either the non-existence of sufficient appropriate internal controls or, where such controls exist, in their deliberate, fraudulent override by employees and management.

CONCLUSION ON AUDITING STANDARD DEFICIENCIES

The common thread running through the above discussion is that auditors, at their own peril, are not doing enough to safeguard themselves. We need to realise in all seriousness that out of all the professions in India, the auditing profession is the most heavily regulated, and under the keenest social and media scrutiny. With the regulatory outreach increasing each year, auditors are getting beleaguered from all sides.

To practice in this unwelcome environment, we have to take care of ourselves because no one else will take care of us. Even the self-regulatory powers of our Institute have largely been diluted with the advent of NFRA. We need to de-risk our practice by being selective about the clients we serve, charge them fees that are commensurate with the effort and risk that we undertake, and follow the auditing standards to (a) perform quality audits, and (b) create sufficient appropriate evidence that we did so. Our audit files must stand up to defend us if we are under attack from any quarter.

ACCOUNTING STANDARD DEFICIENCIES

The QRB review is not really an in-depth review. It is a review of the audited financial statements and documented workpapers found in audit files. Consequently, if one looks at the deficiencies that the QRB Report highlights in the area of Accounting Standards, most of them are in the nature of disclosure and presentation deficiencies.

The QRB apparently has done negligible review work in testing of the recognition and measurement aspects of accounting standards as is reflected from the very few comments, if any, that are made in relation to those deficiencies. In fact, even in the predominantly recognition and measurement standards, such as AS 9 – Revenue Recognition, the QRB comments largely focus on a lack of proper disclosures.

That, however, does not mean that there are no deficiencies in the areas of recognition and measurement. In fact, it makes one worry because, if put on a scale, it is more of recognition and measurement deficiencies that result in fraudulent financial reporting than disclosure or presentation deficiencies.

Practitioners should therefore not feel relieved by the fact that the QRB Report appears to give a clean chit as far as accounting standard deficiencies in the area of recognition and measurement go. The fact that the QRB Report has highlighted so many disclosure and presentation deficiencies (which are too diverse and topical to be individually commented upon in this analysis of the QRB Report) may be extrapolated to point to the extent of non-compliance with even the recognition and measurement standards. Besides, as pointed out at the inception, it is not understood why the QRB has made no comment at all on Ind-AS deficiencies which could be even more pronounced than AS deficiencies, given that those standards are relatively new and more complex than AS.

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BEST OF THE REST

Rahul Sarda,
Advocate

Owner's risk clause in valet parking of hotel – Does not absolve Hotel of liability in case of loss of vehicle due to theft

The Original Complainant No. 2 visited the Appellant-hotel in his Maruti Zen car. While the car was insured with Respondent No. 1 (Complainant No. 1/Insurance Company), the Appellant-hotel had taken a non-industrial risk insurance/liability policy from Respondent No. 3. Upon reaching the hotel, Original Complainant No. 2 handed over his car and its keys to the hotel valet for parking, and then went inside the hotel. The parking tag handed over to him read inter alia:

> *"IMPORTANT CONDITION: This vehicle is being parked at the request of the guest at his own risk and responsibility in or outside the Hotel premises. In the event of any loss, theft or damage, the management shall not be held responsible for the same and the guest shall have no claim whatsoever against the management."*

When Original Complainant No. 2 came out of the hotel, he was informed that his vehicle had been driven away by another person. Respondent No. 1 (car insurer) settled the insurance claim raised by Original Complainant No. 2 (car owner) in respect of the stolen car for ₹ 2,80,000. Thereafter, he executed a Power of Attorney ('POA') and a letter of subrogation in favour of Respondent No. 1 and both of them approached the State Commission by filing a complaint against the Appellant-Hotel seeking payment of the value of the car and compensation for deficiency in service. After initially dismissing the complaint, upon remand, the State Commission allowed the complaint and directed the Appellant-hotel to pay the insurer a sum of ₹ 2,80,000 (the value of the car) with interest, litigation costs and compensation to Original Complainant No. 2 for inconvenience and harassment faced by him.

The National Commission applied the principle of *infra hospitium* and observed that common law imposed strict liability on a hotel for the loss of a guest's property if the guest and the property were within the hotel premises and once the guest presents the car keys to the valet and possession of the car is transferred from the guest to the hotel, a relationship of bailment was established. Relying on various decisions by foreign Courts on strict liability for property kept *infra hospitium*, the National Commission held that the liability of a hotel cannot be precluded by a printed notice on the parking tag disclaiming liability.

The Supreme Court considered inter alia the following questions:

(i) Whether the Appellant-hotel can be held liable for the theft of a car taken for valet parking, under the laws of bailment or otherwise?

(ii) If the second question is answered in the affirmative, what is the degree of care required to be taken by the Appellant-Hotel?

(iii) Whether the Appellant-hotel can be absolved of liability by virtue of the owner's risk clause?

Having held that the consumer complaint filed by the insurer company as co-complainant with the owner of the car was maintainable, the Court held that if the hotel is made strictly liable for the safety of vehicles of these persons without proof of negligence on its part, it may lead to grave injustice. Given the growing number of visitors, hotels cannot be expected to maintain surveillance of each and every vehicle parked on their premises at all times. It further considered it necessary to balance the interests of hotel owners and guests so that the persons visiting hotels and parking their cars in their premises or under valet parking, cannot be left at the mercy of hotel owners.

The Court held that the general rule has been that in a contract of bailment, if goods are lost or damaged while in the possession of the bailee, he will be liable. The burden of proof will be on the bailee to show that he took a reasonable degree of care in respect of the bailed goods. In a situation where the hotel actively undertakes to park the vehicle for the owner, keep it in safe custody and return it upon presentation of a parking slip in a manner such that the parking of the vehicle is beyond the control of the owner, a contract of bailment exists. Thus, the hotel would be liable as a bailee for returning the vehicle in the condition in which it was delivered. The Court further held that valet parking service, even if offered gratuitously, benefits the hotel and such a service is pitched as a value addition to the experience of a guest and incentivises greater footfall. Therefore, for such cases, there exists an implied consideration for the contract of bailment created by virtue of the valet parking service.

In the present case, the burden of proof was on the hotel (bailee) to show that efforts were undertaken by it to take reasonable care of the vehicle bailed, and that the theft did not occur due to its neglect or misconduct.

Held that it was not sufficient for the hotel to merely appoint an attendant or security guard who takes the responsibility of parking the vehicle and keeping the car keys in his custody until the vehicle owner is inside the hotel premises. The hotel must take additional steps to guard against situations which may result in wrongful loss or damage to the car. This includes, for example, ensuring that the car keys are kept out of reach of outsiders, that the valet parks the car in a safe location, that parking spaces which are in the vicinity of the hotel are well guarded, that parking spaces inside the hotel (if any) are reasonably well-maintained and CCTV cameras are installed there for detecting any suspicious activity, that the car is handed over only to those who present the parking slip and so on. It is irrelevant as to how much parking fee was paid by the consumer, or whether any parking fee was paid at all, as the duty of care required to be taken by the hotel will be the same in all circumstances. Clearly the Hotel had failed to discharge the burden of disproving the *prima facie* case of negligence against it. Where the hotel or its servants have actively connived against or acted negligently in safeguarding the vehicles delivered for valet parking, 'owner's risk' clauses in the parking token will not come to their rescue.

Taj Mahal Hotel vs. United India Insurance Company Ltd. & Ors 2019 SCC OnLine 1465 dated 14th November 2019.

Execution of a decree against legal heirs – Legal heirs of partners whether bound by the terms of the partnership deed

During the life time of late Sri Jai Narayan Misra (JNM) and late Smt. Hashmatunnisa Begum (HB), they entered into a partnership deed dated 14-4-1982 for carrying on business in real estate. As per the deed of partnership, the partners had agreed that in the event of the death of either party, their respective legal representatives shall automatically become partners in the partnership firm and they shall continue to act as partners of the firm, till the venture envisaged under said partnership is completed and such legal representatives who became partners shall have the same rights and shall be subject to same liabilities and responsibilities, as the deceased partner.

JNM filed a suit against HB which was decreed directing HB and all the persons claiming through her from carrying the work of developing the property and sale thereof in respect of the property in question and sign the layout plan and other documents for submitting to the authorities concerned. After the death of the original plaintiff, his legal heirs of the plaintiff filed execution petition before the Trial Court.

The Appellants contended that the decree obtained by the predecessor of the Appellants is executable and against the Respondents, who were the legal representatives of the original partner. The Trial Court as well as the High Court have erroneously held that the decree which has become final, is not executable against the respondents.

Held by the Supreme Court that once a partnership comes to an end, by virtue of death of one of the partners, there will not be any partnership existing in which legal representatives of late HB could be taken in. The judgment and decree obtained by late JNM against late HB, in pursuance of partnership deed dated 14-4-1982, cannot bind the legal representatives of late HB, as such, decree is not executable against them. The Respondents were not parties to the partnership deed and that the partnership stood dissolved, in view of death of one of the partners, the Respondents had not derived the benefit of assets of the partnership firm, the decree obtained by the predecessor of the Appellants, was not executable against the Respondents herein.

S. P. Mishra vs Mohd. Laiquddin Khan & Anr., dated 18th October 2019 – Supreme Court

Interplay between SARFAESI Act, Rent Act and Transfer of Property Act – Tenancy rights of a tenant in a property mortgaged by the landlord/ borrower with a bank – Default by landlord/borrower – *Bona fide* tenancy

The property in question was a residential flat which was mortgaged by Respondent No. 2 *viz.* the borrower/landlord with the Respondent No. 1-Bank in equitable mortgage, by depositing title deeds on 20.05.2000, with an intention to secure the credit facility. When the borrower/ landlord failed to make the due repayment of the credit facilities, the bank classified the debt as an NPA and on 30-4-2011 a statutory Demand Notice u/s. 13(2) of the SARFAESI Act was issued to the borrower/landlord demanding payment of ₹ 10,72,10,106.73/-. When the borrower failed to repay the outstanding loan amount, the bank made an application u/s. 14 of the SARFAESI Act seeking directions to take physical possession of the secured asset. This application was allowed by the Chief Metropolitan Magistrate who directed the Assistant Registrar to take possession of the secured asset and handover the same to the bank.

The Appellant, who claimed to be the tenant, asserted that the secured asset was let out to him by the borrower/landlord in January, 2000 and he has been paying rent since then. The Appellant-tenant preferred a suit before the Court of Small Causes at Mumbai against the borrower/landlord.

On 18-9-2012, the Small Causes Court allowed the application for interim injunction of the Appellant-tenant filed in the above suit and the borrower/landlord was restrained from disturbing the possession of the Appellant-tenant.

The Appellant-tenant preferred an application before the Chief Metropolitan Magistrate, Esplanade, Mumbai. By the impugned order dated 31-12-2014, the Chief Metropolitan Magistrate after hearing the Appellant-tenant, rejected the application holding that the Appellant-tenant being a tenant without any registered instrument was not entitled for the possession of the secured asset for more than one year from the date of execution of unregistered tenancy agreement.

The Court held that the *bona fides* of the Appellant-tenant was highly doubtful, as there was no good or sufficient evidence to establish the tenancy. The tenancy claimed was by way of an oral agreement before the mortgage deed was entered into between the borrower and Bank. At the time when the SARFAESI Act proceedings were pending, the factum of tenancy was never revealed by the parties. Where the claim of the Appellant-tenant was not supported by any conclusive evidence, the rejection of the stay application by the Chief Metropolitan Magistrate could not be held to be erroneous.

Further held that the operation of the Rent Act could not be extended to a 'tenant-in-sufferance' *vis-a-vis* the SARFAESI Act, due to the operation of Section 13(2) read with Section 13(13) of the SARFAESI Act. A contrary interpretation would violate the intention of the legislature to provide for Section 13(13), which has a valuable role in making the SARFAESI Act a self-executory instrument for debt recovery. Moreover, such an interpretation would also violate the mandate of Section 35, SARFAESI Act which is couched in broad terms.

The Court declared that the objective of SARFAESI Act, coupled with the T. P. Act and the Rent Act are required to be reconciled herein in the following manner:

(i) If a valid tenancy under law was in existence even prior to the creation of the mortgage, the tenant's possession could not be disturbed by the secured creditor by taking possession of the property. The lease has to be determined in accordance with Section 111 of the TP Act for determination of leases. As the existence of a prior existing lease inevitably affects the risk undertaken by the bank while providing the loan, banks/creditors should conduct a standard due diligence in this regard. Where the bank has proceeded to accept such a property as mortgage, it will be presumed that it has consented to the risk that comes as a consequence of the existing tenancy. In such a situation, the rights of a rightful tenant cannot be compromised under the SARFAESI Act proceedings.

(ii) If a tenancy under law comes into existence after the creation of a mortgage, but prior to the issuance of notice u/s. 13(2) of the SARFAESI Act, it had to satisfy the conditions of Section 65-A of the T. P. Act.

(iii) In any case, if any of the tenants claimed that he was entitled to possession of a secured asset for a term of more than a year, it had to be supported by the execution of a registered instrument. In the absence of a registered instrument, if the tenant relied on an unregistered instrument or an oral agreement accompanied by delivery of possession, the tenant was not entitled to possession of the secured asset for more than the period prescribed u/s. 107 of the T.P. Act.

Bajrang Shyamsunder Agarwal vs. Central Bank of India & Anr. (2019) 9 SCC 94

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THE CHAMBER NEWS

CA Ketan L. Vajani & CA Haresh P. Kenia,
Hon. Jt. Secretaries

Important events and happenings that took place between 1st December 2019 to 31st December, 2019 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The details of new members were admitted to the Managing Council Meeting held on 19th December, 2019 are as under:-

Type of Membership	No. of Members
Life Member	07
Ordinary Member	10
Student Member	05

II. PAST PROGRAMMES

1. DELHI CHAPTER

Full Day Seminar on 'Prevention of Money Laundering, Prohibition of Benami Property Transactions, Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax, Serious Fraud Investigation Office (SFIO) – recent Judicial Developments, Practical Issues, Case Studies' was held on 7th December, 2019 at India International Centre, Lecture Room I, Annexe Building, Dr. K.K. Birla Lane, Max Mueller Marg, Lodhi Estate, New Delhi. The seminar was addressed by Dr. Ashwani Taneja, Mr. R. K. Handoo and Mr. Amit Khemka.

2. INTERNATIONAL TAXATION COMMITTEE

Intensive Study Course on FEMA was held on 13, 14th, 20th and 21st December, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The Course was inaugurated by CA Dilip K. Thakkar. The Course was addressed by CA Rashmin Sanghvi, CA Natwar Thakrar, CA Paresh P. Shah, CA Shabbir Motorwala, CA Anup Shah, Mr. Ashwani Taneja, Advocate, CA Manoj Shah, CA Hinesh Doshi, CA Naresh Ajwani, Mr. Moin Ladha, CA Rajesh P. Shah, CA Ajit Shah, Mr. Sunil Kumar, CA Isha Sekhri, Mr. Prem Rajan Advocate, Mr. Kamlesh Sharma. The brain trust session was chaired by CA Dilip K. Thakkar and the brain trustees were CA Rashmin Sanghvi and Mr. Himansu Mohanty.

3. **IT CONNECT COMMITTEE**
Workshop on Technology Disruption in Financial Industry was held on 6th December, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate. The workshop was addressed by Mr. Ashay Tejwani.

4. **STUDENT COMMITTEE**
Interactive Workshop for Students on GST Annual Return and GST Audit was held jointly with WIRC of ICAI on 18th December, 2019 at St. Xavier's College, Assembly Hall, 1st Floor, Fort, Mumbai. The workshop was addressed by CA Sachin Maher and CA Raj Khona.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of January, 2020)

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I am in the world feeling my way to light 'amid the encircling gloom.'

– Mahatma Gandhi

If faith in ourselves had been more extensively taught and practiced, I am sure a very large portion of the evils and miseries that we have would have vanished.

– Swami Vivekananda

When we tackle obstacles, we find hidden reserves of courage and resilience we did not know we had. And it is only when we are faced with failure do we realise that these resources were always there within us. We only need to find them and move on with our lives.

– A. P. J. Abdul Kalam

Indirect Taxes Committee

Chai pe Charcha on Sabka Vishwas (Legacy Dispute resolution) Scheme, 2019 jointly with Central Board of Indirect Taxes and Customs, Mumbai East Division was held on 4th December, 2019 at Office of the Principal Commissioner, GST, 9th Floor, Lotus Infocentre, Parel.

Dignitaries. seen from L to R: CA Jinit Shah (Member - IDT Committee), Mr. Jarene Tharakan (CGST Superintendent - Mumbai East Commissionerate), CA Rajiv Luthia (Advisor - IDT Committee), CA Pranav Kapadia (Chairman - IDT Committee), Mr. SKH Meshram (Additional Commissioner - Mumbai East Commissionerate), Mr. Rahul Kumar Yadava (Deputy Commissioner - Mumbai East Commissionerate), CA Atul Mehta (Co-Chairman - IDT Committee), CA Sumit Jhunjhunwala (Vice-Chairman - IDT Committee) and CA Keval Shah (Convenor - IDT Committee)

Mr. SKH Meshram (Additional Commissioner - Mumbai East Commissionerate) addressing the delegates

Mr. Rahul Kumar Yadava (Deputy Commissioner - Mumbai East Commissionerate) addressing the delegates

IDT Study Circle on "Issues related to Charitable Organisations Clubs & Associations under GST Law" was held on on 12th December, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate

CA Shailesh Sheth addressing the delegates

CA Ishaan Patkar addressing the delegates

Webinar on "Issues in Sabka Vishwas (Legacy Dispute resolution) Scheme, 2019" was held on 16th December, 2019

CA Manish Gadia addressing the delegates

Study Circle & Study Group Committee

Study Circle Meeting on "Few Controversial issues in Assessment – (Penny Stock, Cash Credits (Loans & Share Premium), 14A and Cash Deposits)" was held on 5th December, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate

CA Ashok Mehta
addressing the delegates

Study Group Meeting on "Recent Judgments under Direct Taxes" was held on 10th December, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate

CA Mahendra Sanghvi
addressing the delegates

CA Chirag Wadhwa
addressing the delegates

Hyderabad Study Group

Hyderabad Study Group Meeting on "MLI – Overview & Application to Indian Enterprises (Case Study Based)" was held on 5th December, 2019 at A La Liberty Restaurant, Road no. 12, Banjara Hills, Hyderabad, Telangana – 500 034

CA Anish Thacker addressing the delegates

Hyderabad Study Group Meeting on "Case studies on GST" was held on 25th December, 2019 at A La Liberty Restaurant, Road no. 12, Banjara Hills, Hyderabad, Telangana – 500 034

CA Venkat Prasad addressing the delegates

Direct Taxes

Webinar on "Assessment of Penny Stock, Capital Gains and Cash Deposits in Demonitisation period" was held on 16th December, 2019

CA Ashok Mehta addressing the delegates

ISG meeting on "Recent Case laws under Direct taxes" was held on 19th December, 2019 at CTC Conference Room

CA Ketan Ved addressing the delegates

International Taxation

INT SC on "Case studies on PPT & GAAR" was held on 17th December, 2019 at CTC Conference Room

Mr. Vinod Ramachandran addressing the delegates

Ms. Krunali Doshi addressing the delegates

Membership & Public Relations

SAS meeting on "Innovation in Start-Up World" was held on 18th December, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate

Mr. Sneh Vaswani addressing the delegates

Capital Market Study circle

Webinar on "Investment Avenues in Current Market Scenario" was held on 18th December, 2019

Mr. Amit Saxena addressing the delegates

Bengaluru Study Group

Bengaluru study group meeting on "Important Judicial pronouncement under RERA" was held on 20th December, 2019 at FKCCI, 3rd Floor, Hall No. 4, K. G. Road, Bengaluru – 560 009

CA Vinay T. addressing the delegates

Delhi Chapter

Full Day Seminar On 'Prevention Of Money Laundering, Prohibition Of Benami Property Transactions, Black Money (Undisclosed Foreign Income And Assets) And Imposition Of Tax, Serious Fraud Investigation Office (SFIO) – Recent Judicial Developments, Practical Issues, Case Studies' was held on 7th December, 2019 at India International Centre Lecture Room I, Annexe Building, Dr. K.K. Birla Lane, Max Mueller Marg, Lodhi Estate, New Delhi – 110 003

– Dignitaries on dais

Standing from L to R: Prakash Sinha, Anil Maheshwari, Amit Maheshwari (All Committee Members of CTC Delhi Chapter)

Sitting from L to R: Amit Khemka (Speaker), Ashwani Taneja (Speaker); Dr. R. N. Dash (Chairman of Sessions); Anil Agarwal (Co-Chairman of Sessions); Vijay Gupta (Chairman of CTC Delhi Chapter); Harpreet Singh (Committee Member of CTC Delhi Chapter)

Mr. Ashwani Taneja, Advocate, Ex-ITAT Member addressing the delegates

Mr. R. K. Handoo addressing the delegates

Mr. Amit Khemka addressing the delegates

IT Connect

Technology Disruption in Financial Industry was held on 6th December, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate

CA Parag Ved, Hon. Treasurer giving his opening remarks. Seen from L to R: CA Murtuza Ghadiyali (Convenor), Mr. Ashay Tejwani (Speaker), CA Maitri Savla (Chairperson) and CA Alok Jajodia (Vice-Chairman)

CA Maitri Savla welcoming the speaker and delegates

Mr. Ashay Tejwani addressing the delegates.

International Taxation

Intensive Study Course on FEMA was held on 13, 14th, 20th and 21st December, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate

Inaugural Session. Seen from L to R: CA Vijay Gupta (Chairman – Delhi Chapter), CA Rashmin Sanghvi (Speaker), CA Vipul Choksi (President), CA Rajesh L. Shah (Chairman) and CA Dilip K. Thakkar (Key Note Speaker)

CA Vipul Choksi (President) giving his opening remarks. Seen from L to R: CA Rajesh L. Shah (Chairman), CA Dilip K. Thakkar (Key Note Speaker), CA Rashmin Sanghvi (Speaker) and CA Vijay Gupta (Chairman – Delhi Chapter)

CA Rajesh L. Shah (Chairman) welcoming the speakers. Seen from L to R: CA Dilip K. Thakkar (Key Note Speaker), CA Vipul Choksi (President), CA Rashmin Sanghvi (Speaker) and CA Vijay Gupta (Chairman – Delhi Chapter)

Brain Trust session chaired by CA Dilip K. Thakkar. CA Rashmin Sanghvi and Mr. Himansu Mohanty (Brain Trustees)

Faculties

CA Dilip K. Thakkar

CA Rashmin Sanghvi

CA Natwar Thakrar

CA Paresh P. Shah

CA Shabbir Motorwala

CA Anup Shah

Mr. Ashwani Taneja, *Advocate*

CA Manoj Shah

CA Hinesh Doshi,

CA Naresh Ajwani

Mr. Moin Ladha

CA Rajesh P. Shah

CA Ajit Shah

Mr. Sunil Kumar

CA Isha Sekhri

Mr. Prem Rajan, Advocate

Mr. Kamlesh Sharma

Student

Interactive Workshop for Students on GST Annual Return and GST Audit jointly with WIRC of ICAI was held on 18th December, 2019 at St. Xavier's College, Assembly Hall, 1st Floor, Fort, Mumbai.

CA Vipul Choksi (President) giving his opening remarks. Seen from L to R: CA Sachin Maher (Speaker) and Ms. Varsha Galvankar (Chairperson)

CA Sachin Maher addressing the students

Ms. Varsha Galvankar (Chairperson) welcoming the speakers. Seen from L to R: CA Vipul Choksi (President) and CA Sachin Maher (Speaker)

CA Raj Khona addressing the students


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