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91st Year

ज्ञानं परमं बलम्

A Monthly Journal of
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VI | No. 4 January 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

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Managing Council Members

Past Presidents Shri Sharad Dalal and Shri Kishor Vanjara handing over gift to children.

Release of CTC Brochure by CTC Office Bearers and Past President Shri Kishor Vanjara

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THE CHAMBER OF TAX CONSULTANTS
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The Chamber's Journal

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

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

Sr. No.	Membership Type		Fees	GST 18%	Total
1.	Life Membership (W.e.f. 1-7-2017)	₹	12000	2160	14160
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Editorial

Wish you all a very happy, peaceful and prosperous year 2018. Francis Bacon says that hope is good breakfast but it is a bad supper. I hope, year 2018 is going to be as exciting as year 2017 was. The year 2017 will be remembered for the disruptions it caused in the field of taxation with the introduction of GST. I hope the Government will walk the talk with respect to removal of glitches in uploading the returns and streamlining the tax slabs of GST. The year 2017 also saw land breaking decisions by the Apex Court especially the decision on privacy. The ramifications of these decisions are going to be multifold and long lasting.

The year 2017 ended on a disturbing note with the loss of precious young lives in a freak accident which took place in an eatery in Mumbai. This incidence has exposed that the upmarket and expensive restaurants do not comply with the safety norms to protect their patrons. This is a bad reflection on our quality consciousness. Unfortunately, again for such facilities also, the regulator happens to be the Municipal Corporation. The reputation of the Corporation in conniving with unscrupulous elements is well-known. But are the people without any remedy? I don’t think so. The people can stop patronising such places and choose only those who ensure the quality of services. Losing precious lives is very shocking. I hope such incidents won’t happen in the coming year.

Special story for the month of January 2018 is on Taxation of Dividend Income. Eminent professionals have contributed to this issue. I hope this will come in handy to the subscribers. Once again, I wish you all a Happy New Year with the words of Khalil Gibran, “In the depth of your hopes and desires lies your silent knowledge of the beyond; And like seeds dreaming beneath the snow, your heart dreams of spring. Trust the dreams, for in them is hidden the gate to eternity.”

K. GOPAL
Editor

From the President

Namaskar,

Dear Members,

I wish all the Members and readers a very Happy and Prosperous New Year.

In this 69th Republic Day we have achieved the dream of One Nation One Tax, which is a milestone in fiscal history of our country. We are noticing the sea change in the tax regime, for which we professionals need to gear up equally to see that the changes are effectively executed.

We are moving towards a clean economy. The efforts of Government in this regard are applaudable. However the path is not easy, we all need to strive for the same for a brighter future India. As tax professionals we have a great role to play in implementation and success of this dream.

As stakeholders we have to be part of this new revolution of Swachh Bharat (which means clean economy and not just clean roads).

The Government is moving towards digital economy. Digitalisation is in every sphere whether it is banking, insurance, tourism or compliance in Government Department e-filing, e-assessment, now our Courts are also paper less. Most of the Government Departments are now digitally connected. On a click of button all information is available. We professionals need to keep pace and adopt the new technologies. Fear or resistance for adopting new technologies is common, however we need to overcome the same. We need to accept the change. Keeping the above development in mind, IT Connect Committee of CTC is coming up with various programmes of professional interest. One such programme Impact of Technology on Audit Function, was useful and informative and well appreciated by our members.

At Chamber, Membership & Public Relations Committee organised Full Day Seminars at Indore jointly with Tax Practitioners Association and at Raipur jointly with Raipur Branch of CIRC of ICAI, and Income Tax Bar Association on the subjects of Demonetisation Issues, Capital Gain, Benami Property & PMLA

Act. The seminars received overwhelming response from Members. This year Chamber has extended its wings to these two cities. Also Chamber is pleased to announce its new initiative – CTC Study Group at Pune.

The 3 day FEMA Conference organised by International Taxation Committee also received an overwhelming response.

This year under the leadership of Shri Naresh Sheth Chairman of Indirect Tax Committee and Ms. Charu Ved, Chairperson of RRC Committee and their strong committed team members, both the Committees have got overwhelming response of participants in their respective RRC.

Team Chamber is eagerly awaiting this event. I would appeal to all seniors in profession to encourage the fresh entrance and to attend RRC's as they get a chance to interact with senior members and gain knowledge and develop their skills and personality.

The Law & Representation Committee has made the representations to the CBDT on difficulties in obtaining 'Legal Heir Certificate' for the purpose of registering deceased assessee's legal heir as representative assessee for e-filing of tax returns of a deceased assessee and to Hon'ble Finance Minister of Maharashtra to extend the due date for filing of VAT Audit Reports for the year 2016-17. Chamber has also made effective pre-budget representation on Direct as well Indirect Taxes before the Committee at Delhi.

The Special Story for the month is on "Dividend". I thank all the authors for sparing their valuable time and for their contribution to the Chamber's Journal for this month.

I end with a quote:

> *Wherever you may be, whatever you may be, if you are willing to strive, you evolve yourself beyond the limitations of nature.*

Happy Republic Day!

Jai Hind!

AJAY R. SINGH
President

Chairman's Communication

Dear Readers,

Wish you a very Happy New Year 2018! Let us hope that the new year will be better in comparison with the year that has gone by. Two major factors which affected the last year were demonetisation and GST. With better GDP projections and Government's promised bounty of investments in infrastructure pouring in, would result in new growth cycle. Banks would also be getting large capital doses which is expected to revive growth in economy.

2018 is the last year of the present term of the Government to deliver on its promise to cut corporate tax rate to 25% which would definitely cheer industry. Besides this, many other measures may be brought to fulfil its promises as also to give boost to the economy. With the ruling party at Centre winning Gujarat elections and ruling the majority of the states of the country, there seems to be overall positive sentiments in the air and stock market is continuing to buoy!

The subject of deemed dividend under Section 2(22)(e) is seemingly a topic which does not need a special issue dedicated to the subject. However, there are so many issues on the subject faced by the assessees as well as the professionals that the committee has thought it fit to come out with an issue dedicated to the subject of Section 2(22)(e). I am sure the readers would find this issue very useful. Credit for designing of this issue goes to the Vice-Chairman of the Committee CA Bhadresh Doshi. Sincere thanks and appreciation for his painstaking efforts.

My gratitude to all the learned authors for sparing their valuable time despite their busy schedule and sharing their knowledge.

Wishing you and your family a Happy Makar Sankranti, Happy Pongal and Happy Lohri!!

Till Gul ghya ani Goad Goad Bola!!

VIPUL K. CHOKSI

Chairman – Journal Committee

The Chamber of Tax Consultants

Vision Statement

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

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

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

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

CA Gautam Nayak

Dividend – An Overview

Meaning of "Dividend"

What do we understand by the term "dividend"? The term flows from a corporate structure, and therefore one first needs to understand its meaning from a corporate law perspective. It has been defined in section 2(35) of the Companies Act, 2013 in an inclusive manner, as *"dividend includes any interim dividend"*. This definition really does not throw any light on what exactly is dividend. There are various other provisions in the Companies Act (sections 123 to 127) which deal with the declaration and payment of dividend. These really do not really throw much light on what exactly is meant by "dividend", except for section 123(1), which provides that no dividend shall be paid by a company for any financial year except out of the profits for that year after providing for depreciation, subject to certain exceptions.

Black's Law Dictionary defines "dividend" as *"a portion of a company's earnings or profits distributed* ***pro rata*** *to its shareholders, usually in the form of cash or additional shares"*. It is therefore a *pro rata* distribution of a company's profits to its shareholders.

In *Mrs. Bacha F. Guzder vs. CIT (1955) 27 ITR 1*, the Supreme Court observed – *"The dividend is a share of the profits declared by the company as liable to be distributed among the shareholders. Reliance is placed on behalf of the appellant on a passage in Buckley's Companies Act (12th Ed., page 894) where the etymological meaning of dividend is given as dividendum, the total divisible sum, but in its ordinary sense it means the sum paid and received as the quotient forming the share of the divisible sum payable to the recipient."* In *Kantilal Manilal vs. CIT (1961) 41 ITR 275 (SC)*, the Supreme Court understood the term in a similar sense as *"'Dividend' in its ordinary meaning is a distributive share of the profits or income of a company given to its shareholders."*

The Punjab & Haryana High Court, expanded on this in *Punjab Distilling Industries Ltd. vs. CIT, (1963) 48 ITR 288*, by analysing the meaning of the term as – *"Speaking generally, "dividend" is a sum of money or portion of divisible thing to be distributed according to a fixed scheme being what the shareholder earns as return on his investment; it is his share of corporate earnings credited to his account. The characteristic feature of "dividend" is that it is declared and paid wholly from the net profits or undivided earnings leaving intact the shareholder's fractional interest represented by his holding in the capital stock. A "dividend" is not capital but the produce of capital. Subject to well recognised limitations, "dividend" is a word of general and indefinite meaning without any narrow, technical or rigid significance. The term "dividend" is applied to a distributive sum, share or percentage arising from* *some joint venture as profits of a corporation. In the second sense, it is a proportionate amount paid on liquidation of a company. In this context "dividend" is being referred to in the sense of corporate profits set apart for rateable division amongst the shareholders, being surplus assets obtained in excess of capital."*

Under Indian income tax law, dividends became taxable for the first time after the Income Tax Act, 1922 was amended to include section 6A, which defined the term "dividend", in a manner similar to the current section 2(22) of the Income-tax Act, 1961, having clauses (a) to (d) of the current definition. Clause (e) was also incorporated in 1955. The current definition in section 2(22) also has the 5 limbs – clauses (a) to (e), which are discussed in the later chapters.

Schemes or Methods of Taxation of Dividend

There are different methods or schemes worldwide of corporate taxation, i.e. taxation of profits of companies and the resulting dividends. Some countries exempt dividends, some tax dividends at a concessional rate, while some give a tax rebate against dividend income.

The fundamental underlying principle behind a concessional taxation for dividends is that ultimately dividends are derived from corporate profits, which have already been subjected to tax. The objective is to try and match the aggregate of corporate and dividend taxes with the personal tax rates, so that there is no advantage in having a non-corporate structure for carrying on business.

The schemes prevalent worldwide are primarily two:

1. **Classical System:** The company is taxed on its profits, and the dividend is also taxed in the hands of shareholders at normal rates of tax. India follows a modification of the classical system, by imposing Dividend Distribution Tax (DDT) on the dividends in addition to tax on the corporate profits. Under this system, the effective tax rate on corporate profits is the maximum, as there is no relief given to shareholders on their dividend incomes.

2. **Imputation system:** This method allows shareholders the benefit of corporate taxes paid by the company. Since imputation credit mechanisms are complex to administer, countries apply them either wholly or partly depending on what they find workable. Australia and Canada follow this system.

There are certain other systems, which are a modification of these two basic systems:

1. **Exemption System:** Dividends are exempted from personal tax, on the logic that corporate profits have already been taxed. The exemption can either be whole or partial. The Indian dividend tax system is not an exemption system even though it exempts shareholders, because it still imposes a DDT at the company level.

2. **Reduced rate of tax:** This method applies a lower rate of tax to dividends than the normal highest rate applicable to individuals. Japan (personal income tax rate of 5 to 45% & dividend tax at 20%), China (personal income tax rate of 3 to 45% & dividend tax at 20% on 50% of dividend income) and South Africa (personal income tax rate of 18-40% & dividend tax at 15%) are examples of countries adopting this system.

3. **Deduction system:** The company's taxable profits are reduced to the extent that distributions are made to shareholders. This option evidently involves timing issues i.e. a reconciliation of the taxable year of the company and the shareholder, which is why it is not as common. Iceland currently follows a version of this system.

4. **Full integration:** In its most extreme form, an imputation system would disregard the tax form of the company entirely and only levy taxes at a single level. This method, known as the "full integration" approach is understandably not commonly used, due to the differences in characteristics of partnerships and companies. Its application is typically limited to companies with partnership like features, such as US S-Corps or limited liability companies.

The scheme of taxation of dividends in some of the major countries is summarised below.

Australia

Australia operates a full imputation system where income of a corporate taxpayer is not subject to further taxation in the hands of the shareholders. Under this system:

- Payments of income tax by a resident company give rise to "imputation" or franking credits that are accounted for in a "franking account". The company distributes its imputation credits with its dividends, thus making the dividends "franked". A distribution of franked dividends reduces the company's imputation credit balance;
- A recipient (corporate or individual) of a franked dividend is required to gross up its dividend income by the received imputation credits and may use the imputation credits to reduce its tax liability. Thus, a receipt of a fully franked dividend by a corporate taxpayer in a taxable position will not result in an additional tax payable by that taxpayer on the dividend. A receipt of franking credits by a corporate taxpayer increases its franking account balance the same way as a payment of income tax on its income. This allows distribution of the credits to the recipient's shareholders;
- Corporate taxpayers may convert the excess credits to tax losses;
- Excess franking credits of individuals and pension funds are refunded; and
- Payments of fully franked dividends to non-residents are not subject to dividend withholding tax.

Brazil

Economic double taxation is avoided via a dividend exemption system under which dividends distributed to either resident or non-resident shareholders from after-tax profits are not subject to any further taxation. After-tax dividends distributed by resident entities are tax exempt. It means that neither withholding tax is levied nor dividends are taxed at the level of the beneficiary.

Canada

The Canadian corporate tax system attempts to achieve integration between corporations and their shareholders, meaning that income passing through a corporation should not attract any additional taxation than income received by an individual directly. As taxes are levied at both the individual and shareholder level, double taxation is partially eliminated through a modified imputation system. The system uses a notional dividend tax credit to provide tax relief in respect of domestic dividends paid to individuals. The dividend tax credit is provided at a fixed rate irrespective of the actual corporate tax rate that may have applied to the corporate income out of which the dividends were generated.

For purposes of calculating the credit, the corporation is considered to have paid the dividend out of one of two pools:

– The low-rate income pool; this is after-tax profit paid out of income that was eligible for the "small business" rate; and

– the general-rate income pool; this is after-tax profit paid out of income that was not eligible for the small business rate.

If the dividend is paid out of the low-rate income pool, a gross-up of 17% of the dividend is applied. If the dividend is paid out of the general-rate income pool, the gross-up is 38% of the dividend (a higher gross-up because the corporation is assumed to have paid a higher rate of corporate tax).

After grossing up the dividend, the individual calculates the individual's federal income tax liability on the grossed-up amount of the dividend (not on the actual amount of the dividend). When the individual calculates the actual amount of federal income tax owing by the individual, however, the individual deducts a dividend tax credit of 21/29 of the 17% gross-up amount if the dividend has been paid out of the low-rate income pool and 6/11 of the 38% gross-up amount if the dividend has been paid out of the general-rate income pool.

Therefore, on a dividend of 100 received by a shareholder, there is an effective tax of 26.30, considering the federal tax rate of 33%, if dividend has been paid out of the low rate income pool, and effective tax of 24.82, if paid out of the general-rate income pool.

China

China operates a classical system of taxation, with reduced rates of tax. Profits are first taxed at the corporate level, and dividends distributed from the profits are taxed in the hands of shareholders with no applicable credits.

However, dividends are taxed at concessional rates. Individuals pay income tax at 20% on dividends received from sources inside and outside China, as against normal tax rates which go up to 45%. Dividends derived by individuals from companies listed on the Shanghai or Shenzhen Stock Exchanges are subject to tax at the following effective rates:

- 10% if the underlying shares are held for a period of between 1 month and 1 year (i.e. the tax base of the dividends is reduced by 50% which results in an effective tax rate of 10%); and
- 20% if the underlying shares are held for less than 1 month (fully included in the tax base).

Dividends derived from listed companies are exempt from individual income tax (IIT) if the underlying shares are held for more than 1 year.

France

France follows the classical system, with reduced rate of tax. Corporate income is first taxed in the hands of the company and dividends are subsequently taxed in the hands of the shareholders at the appropriate rates.

Dividends distributed by resident companies to resident individuals are subject to income tax at the progressive income tax rates for 60% of their amount (i.e. after the deduction of an allowance equal to 40% of the dividends). In addition, all dividends are subject to social taxes at a total rate of 15.5%. From 1st January, 2018, all investment income of a resident individual, including dividends, would be subject to a flat-rate 30% tax (income tax at a flat rate of 12.8% and social taxes at a global rate of 17.2%), as against the normal highest tax rate of 45%.

Germany

Germany also follows the classical system with reduced rate of tax. Under the classical corporate tax system applicable in Germany, corporate profits are taxed at the level of the company and dividends are taxed in the hands of individual shareholders without imputation credits being available for the corporate income tax paid. Economic double taxation, however, is currently mitigated for individual shareholders by a partial-income system or final flat withholding tax.

Category 5 Income from private capital investment (which includes dividends) is taxed separately by way of a final flat withholding tax at a rate of 25%, increased to 26.375% by the solidarity surcharge, as against the highest tax rate of 45%. Business income of individuals from investment in shares is taxed under a partial-income system, i.e. 60% of the dividend income is taxable.

Hong Kong

Hong Kong follows the exemption system. Under Hong Kong tax laws, dividends are exempt from all taxes. There is therefore only a single level of corporate taxation.

South Africa

South Africa operates an exemption system of corporate income taxation. Domestic dividends are generally exempt from tax.

Singapore

Singapore earlier followed an imputation system, but switched over to an exemption system from 2003. All dividends paid by resident companies are now exempt in the hands of shareholders at all levels.

United Kingdom

The UK now follows the classical system of taxation with reduced rate of tax. Till 2015-16, it followed the imputation system, whereby the tax credit attached to the dividend was equal to one-ninth of the dividend. The individual's taxable income amounted to the "gross dividend", i.e. the dividend plus the tax credit, and the tax credit was then offset against the gross dividend.

Though dividends are now taxable, there is a tax-free dividend allowance, amounting to GBP 5,000 (to be reduced to GBP 2,000 from 2018-19). Further, in case dividends exceed GBP 5,000, then the entire dividends are taxed at special rates, depending upon the tax slabs that the taxpayer is in. For 2017-18, these are as follows:

	Tax rate (%)
Dividend ordinary rate (applicable to dividends that would otherwise fall within the basic rate of 20% – income from GBP 0 to GBP 32,000)	7.5
Dividend upper rate (applicable to dividends that would otherwise fall within the higher rate of 40% – income from GBP 32,001 to GBP 1,50,000	32.5
Dividend additional rate (applicable to dividends that would otherwise fall within the additional rate of 45% – income over GBP 1,50,000	38.1

United States of America

The USA does not use an imputation system for corporate dividends, but uses the classical system, under which income is taxed at the corporate level when earned and taxed a second time at the shareholder level when distributed as dividends. There are however reduced tax rates for dividends.

Qualified dividends received by individuals are subject to tax at the reduced rates applicable to long-term capital gains. For 2017, the rates are 20%, 15% or 0%, depending on the tax bracket that applies to the individual's ordinary income, as against the highest tax slab of 39.6%. The reduced rates apply to dividends received from domestic corporations and from qualifying foreign corporations. To qualify for the reduced tax rate on dividends, the shareholder must meet a holding period requirement. In the case of common stock and most preferred stock, the holding period requirement is that the stock must be held for at least 61 days during the 121-day period that commences 60 days prior to the date the stock becomes ex-dividend. In the case of preferred stock paying a dividend attributable to periods in excess of 366 days, the required holding period is 91 days during the 181-day period that commences 90 days prior to the date the stock becomes ex-dividend. There are no significant changes to the scheme of taxation of domestic dividends under the recent US tax reforms.

Comparison of Indian system with other Worldwide Systems

The Indian system of taxation of dividends is the classical system with modifications, which worsen the tax impact. Not only is the effective tax rate fairly high at 45.914% of the corporate profits, being the full corporate tax rate of 34.608% and the DDT at 17.304%, but it is also inequitable, as shareholders in the highest and lowest slab rates suffer the same rate of DDT. In case of shareholders with dividends exceeding ₹ 10 lakh, the position is aggravated with the 10% tax u/s. 115DDA, raising the effective tax rate to 52.32% of the corporate profits.

As opposed to a maximum marginal rate of 35.535%, this high effective tax rate is a significant discouragement to carrying on of business in a corporate form. Carrying on an activity through a partnership firm or an LLP or even a proprietary concern would be far more advantageous from a tax perspective, in terms of a much lower tax rate than a company.

Most countries have a far lower effective tax rate on corporate profits and dividends. The table in Annexure A, extracted from stats.oecd.org, shows the effective tax rates, consisting of corporate income tax (CIT) plus personal income tax (PIT) rates, in some major countries. As is evident from the table, only developed countries, such as Belgium, Canada, Denmark, France, Ireland, Korea and the USA (before the recent tax reforms) have comparable high effective tax rates. All other countries have much lower effective tax rates. If India desires high levels of corporate investment, it certainly needs to rationalise its effective combined tax rates on corporate profits and dividends. To some extent, this would come about by the reduction in the corporate tax rates to 25% as proposed by the Finance Minister in his Budget Speech 2016, wherein he had promised to reduce the corporate tax rates to 25% by 2019.

Further, the ostensible exemption granted to dividends in the hands of shareholders creates its own set of problems. Interest incurred on borrowings to acquire shares is not an allowable expenditure, even though the dividends are effectively taxed. The disallowance under section 14A gets artificially increased by inclusion of dividends as an exempt income, though such dividends is economically taxed. Some taxpayers are tempted to resort to dividend stripping, on account There is also an issue as to whether non-resident shareholders would get a tax credit in their country of residence for such DDT paid on the dividends earned by them.

There is also clearly an urgent need to simplify the whole scheme of dividend taxation. There are today complex provisions of grossing up for the purposes of DDT, complexities in determination of expenses incurred to earn dividend income for disallowance of such expenses and further determination of the level of dividends, to ascertain whether the tax u/s. 115BBDA applies.

One hopes that these complexities and inequities in dividend taxation will be addressed in the forthcoming budget, perhaps by reverting to the classical system of taxation prevalent earlier. Given the strains on the budget, that is the best that one can hope for, though ideally one would have wished for an exemption or imputation system.

Table A – Overall statutory tax rates on dividend income

Year	**2017**												
Unit	**Percentage**												
Overall statutory tax rates on dividend income		CIT rate on distributed profit	Pre-tax distributed profit	Distributed profit	Final withholding tax	PIT rate on (grossed-up) dividend	Grossed-up dividend	Imputation rate	Imputation/ dividend tax credit	Net personal tax	Overall PIT + CIT rate	CIT/PIT+CIT	PIT/PIT+CIT
Country													
Australia	i	30.00	142.86	100.00	..	47.00	142.86	30.00	42.86	24.28	47.00	63.83	36.17
Austria	i	25.00	133.33	100.00	27.50	27.50	..	..	..	27.50	45.63	54.80	45.20
Belgium		33.99	151.49	100.00	..	30.00	..	..	..	30.00	53.79	63.19	36.81
Canada	i	26.70	136.43	100.00	..	53.53	138.00	25.02	34.53	39.34	55.54	48.07	51.93
Chile	i	25.00	133.33	100.00	..	35.00	133.33	25.00	33.33	13.33	35.00	71.43	28.57
Czech Republic	i	19.00	123.46	100.00	15.00	15.00	..	..	..	15.00	31.15	61.00	39.00
Denmark	i	22.00	128.21	100.00	..	42.00	..	..	..	42.00	54.76	40.18	59.82
Estonia	i	20.00	125.00	100.00	..	0.00	..	..	..	0.00	20.00	100.00	0.00
Finland	i	20.00	125.00	100.00	..	34.00	..	..	..	28.90	43.12	46.38	53.62
France	i	36.40	157.23	100.00	..	44.00	..	..	..	44.00	64.38	56.54	43.46
Germany	i	30.18	143.22	100.00	26.38	26.38	..	..	..	26.38	48.59	62.10	37.90
Greece	i	29.00	140.85	100.00	15.00	15.00	..	..	..	10.00	36.10	80.33	19.67
Hungary	i	9.00	109.89	100.00	..	15.00	..	..	..	15.00	22.65	39.74	60.26
Iceland	i	20.00	125.00	100.00	..	20.00	..	..	..	20.00	36.00	55.56	44.44
Ireland	i	12.50	114.29	100.00	..	51.00	..	..	..	51.00	57.13	21.88	78.12
Israel	i	24.00	131.58	100.00	..	27.00	..	..	..	27.00	44.52	53.91	46.09
Italy	i	24.00	131.58	100.00	26.00	26.00	..	..	..	26.00	43.76	54.84	45.16
Japan	i	29.97	142.80	100.00	20.32	20.32	..	..	..	20.32	44.20	67.81	32.19

Overall statutory tax rates on dividend income		CIT rate on distributed profit	Pre-tax distributed profit	Distributed profit	Final with-holding tax	PIT rate on (grossed-up) dividend	Grossed up dividend	Imputation rate	Imputation / dividend tax credit	Net personal tax	Overall PIT + CIT rate	CIT / PIT+CIT	PIT / PIT+CIT
Korea	i	24.20	131.93	100.00	..	41.80	111.00	9.91	11.00	35.40	51.03	47.42	52.58
Latvia		15.00	117.65	100.00	..	10.00	..	..	..	10.00	23.50	63.83	36.17
Luxembourg	i	27.08	137.14	100.00	..	42.00	..	..	..	21.00	42.39	63.88	36.12
Mexico	i	30.00	142.86	100.00	10.00	42.00	142.86	30.00	42.86	17.14	42.00	71.43	28.57
Netherlands	i	25.00	133.33	100.00	..	25.00	..	..	..	25.00	43.75	57.14	42.86
New Zealand	i	28.00	138.89	100.00	..	33.00	138.89	28.00	38.89	6.94	33.00	84.85	15.15
Norway	i	24.00	131.58	100.00	..	29.76	..	..	..	29.76	46.62	51.48	48.52
Poland	i	19.00	123.46	100.00	19.00	19.00	..	..	..	19.00	34.39	55.25	44.75
Portugal	i	29.50	141.84	100.00	25.00	28.00	..	..	..	28.00	49.24	59.91	40.09
Slovak Republic	i	21.00	126.58	100.00	7.00	7.00	..	..	..	7.00	26.53	79.15	20.85
Slovenia	i	19.00	123.46	100.00	25.00	25.00	..	..	..	25.00	39.25	48.41	51.59
Spain	i	25.00	133.33	100.00	..	23.00	..	..	..	23.00	42.25	59.17	40.83
Sweden	i	22.00	128.21	100.00	..	30.00	..	..	..	30.00	45.40	48.46	51.54
Switzerland	i	21.15	126.82	100.00	..	21.14	..	..	..	21.14	37.81	55.93	44.07
Turkey	i	20.00	125.00	100.00	..	35.00	..	..	..	17.50	34.00	58.82	41.18
United Kingdom	i	19.00	123.46	100.00	..	38.10	100.00	0.00	0.00	38.10	49.86	38.11	61.89
United States	i	38.91	163.68	100.00	..	28.51	..	..	..	28.51	56.32	69.08	30.92
Data extracted from OECD.Stat													

Dr. S. Chandrasekaran

Provisions of Companies Act

Declaration and distribution of dividend in compliance with Companies Act

Dividend is a return on the investment made in the share capital of a company, as distinct from the return on borrowed capital, which is in the form of interest. It is that portion of profit of a company, which is not required to be retained in the business and is distributed among the shareholders in proportion to the amount paid-up on the shares held by them. The Companies Act (the Act) has defined "Dividend" which includes any interim dividend. It is an inclusive and not an exhaustive definition. The Institute of Company Secretaries of India has issued Secretarial Standard 3 on Dividend in November, 2017, effective from January 1, 2018, which is recommendatory for the time being.

Dividends are usually payable for a financial year after the final accounts are ready and the amount of distributable profits is available to declare at the Annual General Meeting. However, it is also in practice to declare dividend in between the year in the form of Interim dividend. It is to be noted that capitalisation of profits in the form of bonus shares is not Dividend. Further, distribution of discount coupons to all the shareholders is also not to be treated as deemed dividend.

Types of Dividend

The declaration of dividend is of two types, i.e., Final Dividend and Interim Dividend. Final dividend, is the dividend for a financial year which is declared at the annual general meeting (AGM) on the recommendation of the Board of Directors. The board at the time of finalisation of financial results consider the quantum of dividend to be distributed and accordingly incorporate such sum in the financial statements of the company. Interim Dividend, is the dividend that is paid by the Board of Directors between two AGMs without declaring them at an AGM. It is paid out of the surplus in the profit and loss account and/or out of profits of the financial year in which such dividend is sought to be declared.

Declaration of dividend on Equity Shares is based on the profits earned and the quantum of profit to be distributed to the equity shareholders after retaining certain earnings for future requirements and to be used for its business purposes. Additionally, if the Company has also adopted any dividend policy, then the terms mentioned in the policy shall also be complied while declaring and distributing the dividends. Where a company has issued equity shares with differential rights as to dividend, the board may consider and declare interim dividend on all or any one or more classes of such shares in accordance with the terms of issue of equity shares.

Dividend on preference shares is always at a fixed rate and it has a preference over the dividend on equity shares. Preference shares can also be with different rate of dividend in terms of the issue of such preference shares.

Provisions relating to dividend under the Act

The Act stipulates certain conditions and compliance for declaration of dividend.

No dividend shall be declared or paid by a company for any financial year except –

(a) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the Act, or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the Act and remaining undistributed, or out of both, or

(b) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company so as to meet any contingencies. It is also mandatory that the Board of Directors must state in the Directors' report the amount of dividend, if any, which it recommends to be paid.

Companies licensed under Section 8 of the Act; i.e., Non-Profit Organisations are prohibited by their constitution from paying any dividend to its members.

Time Limit for payment of dividend

A separate bank account has to be opened for declaration and payment of dividend as the dividend account of the Company. The amount of dividend (final as well as interim) shall be deposited in that separate bank account within five days from the date of declaration of such dividend.

The distribution of dividend to shareholders has to be made within thirty days from the date of declaration.

Dividend once declared becomes a debt and shall not be revoked.

Conditions for payment of dividend

No dividend shall be declared or paid by a company from its reserves other than free reserves. Further, dividend out of Free Reserves can also be declared only after complying certain conditions.

Dividend shall not be declared out of the Securities Premium Account or the Capital Redemption Reserve or Revaluation Reserve or Amalgamation Reserve or out of profits on reissue of forfeited shares or out of profits earned prior to incorporation of the company.

A company shall also not declare any dividend, if it has defaulted in following payments till such default is subsisting –

(a) Redemption of debentures or payment of interest thereon or creation of debenture redemption reserve,

(b) Redemption of preference shares or creation of capital redemption reserve,

(c) Payment of dividend declared in the current or previous financial year,

(d) Repayment of any term loan to a bank or financial institution or interest thereon.

Dividend shall only be paid to the registered shareholder of such share or to his order or to his banker.

Declaration of dividend out of Company's Reserves

In the event of inadequacy or absence of profits in any year, a company may declare dividend out of surplus reserves subject to the fulfilment of the following conditions –

- The rate of dividend declared shall not exceed the average of the rates at which dividend was declared in the 3 years immediately preceding that year (provided that this rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial years).
- The total amount to be drawn from such accumulated profits shall not exceed an amount equal to one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
- The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
- The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statements.

Mode of payment

Payment of dividend is to be made only by way of cash. However payable in cash may be by way of cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

Dividend kept in abeyance

Where an instrument for transfer of shares has been lodged and the transfer has not taken place due to any dispute between the transferor and transferee, the company has to keep dividend on such disputed shares in abeyance and can only be paid on completion of transfer formalities.

Unpaid dividend account

Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account in any scheduled bank to be called the Unpaid Dividend Account.

Any money transferred to the Unpaid Dividend Account which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, to the Fund established by Central Government i.e., Investor Education and Protection Fund.

Investor Education and Protection Fund

Any money transferred to the Unpaid Dividend account which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, to the Investor Education and Protection Fund (IEPF) established by the Central Government. Shareholders who have not claimed their dividend which has been transferred to the IEPF can claim the same from the Fund.

Recently, the Central Government also notified that the shares in respect of which dividend has not been paid or claimed for seven consecutive years or more shall also be transferred to the IEPF Authority and, of course, shareholders can claim from the said authority at any point of time. All benefits accruing on said shares transferred shall also be transferred to the IEPF.

Penal Provisions

Where a dividend has not been paid by the company within thirty days from the date of declaration, every director who is knowingly a party to the default, be punishable with imprisonment for a term which may extend to two years and shall also be liable to a fine of ₹ 1,000 for every day during which default continues and the company shall be liable to pay simple interest @ 18% per annum during the period for which such default continues.

If the company delays the transfer of the unpaid/unclaimed dividend amount to the unpaid dividend account, it shall pay interest @ 12% p.a. till it transfers the same and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

Where a company fails to comply with any of the requirements of section 124 of the Act, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Additional compliances for listed entities

- The listed entity shall declare and disclose the dividend on per share basis only.
- Prior two working days intimation to stock exchanges about the meeting of the Board of Directors in which proposal for declaration/ recommendation of dividend will be considered by the board.
- Intimation to the stock exchanges within 30 minutes of the closure of the Board meeting in which dividends recommended or declared or the decision to pass any dividend and the date on which dividend shall be paid/ dispatched.
- Intimation to the stock exchanges of the record date for the declaration of dividend by giving notice in advance of not less than seven working days.
- The listed entity shall recommend or declare all dividend and/or cash bonuses not less than five working days before the record date fixed for the purpose.
- The top five hundred listed entities based on market capitalisation (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy and be disclosed in their annual reports and on their websites.

Companies Amendment Bill, 2017

Companies Amendment Bill, 2017 which was passed by Lok Sabha on 27th July, 2017 and recently passed by Rajya Sabha on 19th December, 2017 is yet to get the President's assent to become the Act.

The important features on the Bill in regard to dividend are as under:

- In the computation of profits for the purpose of declaring dividend, any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded.
- In the case of inadequate or absence of profits in any financial year, dividend can be declared out of accumulated profits earned by the company in previous years and transferred by the company to free reserves (instead of reserves).
- The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the AGM out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend. In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during immediately preceding three financial years, which enumerates that a company which has not declared the dividend in last three financial years shall not be eligible to declare interim dividend.

Conclusion

Declared dividend is the legitimate due to every shareholder. In order to protect the interest of the shareholders, dividend has to be kept in a separate bank account so that the company does not use such funds for business operations. At the same time, keeping the unpaid dividend account in a separate bank account for longer time is of no use and, therefore, Government rightly thought it fit to transfer such unclaimed dividend account to the Central Government for right use of funds of the public. Now, in order to protect the shareholders interest, further, the shares for which dividend amount has been transferred to IEPF is also to be transferred to the IEPF authority so as to avoid any fraudulent or misuse of such shares. However, the shareholders can claim both, either dividend or shares transferred to IEPF at any point of time after establishment of their legal entitlement.

In order to conclude, we can say that decision of declaration dividend is call of the management of the company depending upon the profitability of the Company. However, once declared, it becomes liability on the company and right of the shareholder to receive the amount of declared dividend in compliance of the provisions of the Act.

Perfection does not come from belief or faith. Talk does not count for anything. Parrots can do that. Perfection comes through selfless work.

— Swami Vivekananda

Bharath Janarthanan, *Advocate*

Accumulated Profits

The term "accumulated profits" assumes great significance in taxation of dividends under the Income-tax law. The very foundation of taxation of dividends under section 2(22) of the Income-tax Act, 1961 ("the Act") is the existence of profits (whether accumulated or current) as distribution of dividends to the shareholders of the company can be made only out of the profits (either capital or revenue) and not out of capital unless it is a reduction of capital. *Lord Russel of Killowen in Hill (RA) vs. Permanent Trustees Co of New South Wales Ltd [LR (1949) AC 361 (HL)]* observed as follows, *"A limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorised reduction of capital. Any other payment made by it by means of which it parts with moneys to its shareholders must and can be made by way of dividing profits. Whether the payments is called 'dividend' or 'bonus', or by any other name, it still remains a payment on division of profits."*

Taxation of dividends under section 2(22) of the Act is restricted to the extent of the available accumulated profits in the hands of the company in the scenarios envisaged in clauses (a) to (e) therein. If the distributions/payments made under those clauses are less than the accumulated profits, then the entire distributions/payments are taxed as dividend under Section 2(22) of the Act. On the contrary, if the distributions/payments are more than the accumulated profits, then the taxability would be restricted to the amount of accumulated profits computed therein.

1.1. What is "accumulated profit"?

Explanation 1 and Explanation 2 to Section 2(22) of the Act define "accumulated profits" as under:–

> *"Explanation 1 – The expression "accumulated profits wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after 31st day of March, 1948, and before the 1st day of April, 1956.*
>
> *Explanation 2 – The expression "accumulated profits" in sub-clauses (a), (b), (d) and (e) shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the*

> *company prior to three successive previous years immediately preceding the previous year in which such acquisition took place.*

Explanation 2 makes it very clear that the accumulated profits shall include all the profits of the company up to the date of distribution or payment to shareholders. It was a settled position under the 1922 Act in view of the decision of the Supreme Court in *CIT vs. Damodaran (1980) 121 ITR 572 (SC)* which interpreted "accumulated profits" to not include "current profits" i.e the profits of the financial year in which distribution/ payment takes place. However, under the 1961 Act, this distinction was done away with and *Explanation 2* was introduced to impliedly mean that the accumulated profits would include current profits. It would mean that whatever profits are earned by the company including that of previous years till the date of distribution/payment shall be taken into consideration.

The next question which arises is what does the term "profit" imply? Whether it would include only the balance in the profit and loss account or also the reserves? If so, what are the types of reserves which would come within the ambit of "accumulated profits"?

The Supreme Court in the case of *P. K. Badiani vs. CIT 105 ITR 642 (SC)* held that the expression "accumulated profits" occurring in clause (e) of Section 2(6A) of 1922 Act (similar to Section 2(22)(e) of the 1961 Act) or in any other clauses would mean profits in commercial sense and not profits liable to tax under section 1922 Act, that is to say profits in real and true sense of the term. In other words, it would mean that the actual profit earned by the assessee computed as per the profit and loss account has to be considered and not the profit computed as per the Income-tax Act which is a result of various allowances/disallowances prescribed therein. In the decision of the Bombay High Court in the case of *Navnitlal C. Jhaveri vs. CIT 80 ITR 582*, it has been held, *"Now, 'accumulated profits' signifies, firstly, that there must have been profits in earlier years and, secondly, that amounts out of such profits have been accumulated from time-to-time, with the result that there is some amount of accumulated profits in the possession of the company just before the commencement of the accounting year in this reference."* Thus, it is the commercial profit which has to be taken into consideration to ascertain the accumulated profit, which is nothing but profit arrived at after providing for depreciation in the books of accounts. In other words, it would be the profits available for distribution as dividends to the shareholders (out of current as well as previous years profits). However, a contrary view was expressed by the Hon'ble Bombay High Court in the case of *CIT vs. Jamnadas Khimji Kothari 92 ITR 105 (SC)* wherein it was held that the depreciation rate as per the Income-tax Act has to be taken into account to arrive at the accumulated profits. It is submitted that this decision does not hold the field today in view of the decision of the subsequent decision of the Supreme Court in P. K. Badiani's case (supra). If the rate as per the provisions of Income-tax Act was to be adopted, then it would, in strict sense, not be a commercial profit as, in certain cases, due to higher rate of depreciation provided under the Act (like 80% in the case of wind mills), the WDV would be reduced to a negligible amount in span of 4-5 years as against its normal life span which is much higher and the depreciation on the same has to be provided for based on the average life span of the asset which would result in portraying true and real profit. In another decision of the Supreme Court in the case of *CIT vs. Urmila Ramesh 230 ITR 422 (SC)*, it has been held that the balancing charge determined under Section 41(2) of the Act cannot be taken into account for the purpose of computation of accumulated profits as it is only the real profits which have to be taken into account and not deemed profits and that *"Section 2(22) has used the expression 'accumulated profits',* *whether capitalised or not. This expression tends to show that under section 2(22) it is only the distribution of the accumulated profits which are deemed to be dividends in the hands of the shareholders. By using the expression 'whether capitalised or not' the legislative intent clearly is that the profits which are deemed to be dividend would be those which were capable of being accumulated and which would also be capable of being capitalised. The amounts should, in other words, be in the nature of profits which the company could have distributed to its shareholders. This would clearly exclude return of part of a capital to the company, as the same cannot be regarded as profit capable of being capitalised, the return being of capital itself. Profits mean only commercial profit."*

1.2 Inclusions/exclusions from accumulated profits

The next question which is to be considered is whether it is only the balance in the profit and loss account that has to be taken into account or whether, other reserves like general reserves etc. are also to be included in accumulated profits. In my view, those reserves which are appropriated from profits in the previous years and are available for distribution to shareholders are to be taken into account to ascertain the accumulated profits i.e. like general reserve etc. It has been held by the Madras High Court in *G. Ramasamy Naidu vs. CIT – 86 ITR 768* which is followed in *CIT vs. G. Venkataraman 101 ITR 673 (Mad. HC)* that the development rebate reserve is a free reserve and there is no bar on distribution of the same to the shareholders and therefore, is to be included for the purpose of computation of accumulated profit. The same has also been held by the Bombay High Court in the case of *Star Chemicals Pvt Ltd. vs. CIT 203 ITR 11* which follows the decision of *P. K. Badiani vs. CIT* (supra).

Further, to the question of whether capital gain has to be included in the accumulated profits is concerned, the underlying assumption of *Explanation 1* to Section 2(22) of the Act is that only the taxable capital gain would form part of the accumulated profits and not the capital gains earned by the company during the period when they were not taxable (i.e) before 1-4-1946 and between 1-4-1948 and 31-3-1956. It would also not include a capital gain which is exempted from tax i.e on sale of agricultural assets. In the decision of the Hon'ble Apex Court in the case of *ITO vs. Short Bros (P) Ltd. (1976) 60 ITR 83 (SC)*, the assessee had sold the coffee estates and incurred a capital gain on the same which was not chargeable to tax as the asset was an agricultural land which is not a capital asset. Dividends were paid to shareholders during the year out of those profits and the question arose whether such profit ought to have been included in 'accumulated profits'. It was held by the Supreme Court that the term *"'accumulated profits' are, therefore, profits which are so regarded in commercial practice, and capital gains as defined in the Income-tax Act. Realization of appreciated value of assets in commercial practice is regarded as realization of capital rise, and not of profits of the business. Unless, therefore, appreciation in the value of capital assets is included in the capital gains, distribution by the liquidator of the rise in the capital value will not be deemed dividend for the purpose of the Income-tax Act"*. Similar view has been taken in another decision of the Supreme Court in *Tea Estate India (P) Ltd. vs. CIT 103 ITR 785 (SC)*. In another decision of the Bombay High Court in the case of *CIT vs. Mangesh J. Sanzgiri 119 ITR 962*, it was held that the amount distributed to the shareholders cannot be assessed as dividend as there was no capital gain which was chargeable to tax on sale of machinery, land etc. due to substitution of fair market value as cost of acquisition even though there was a profit on the sale therein.

Another issue which has to be considered is whether the share premium collected on issue of shares can form part of accumulated profits of the company. Under section 52(2) of the Companies Act, 2013 (Corresponding provision to section 78(2) of the Companies Act, 1956), the securities premium account can be used only for the purposes mentioned viz.,

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under Section 68.

Therefore, it is very much evident that the share premium is not available for distribution to the shareholders as dividends. It, therefore, follows that such premium shall not be taken into account while computing "accumulated profits" for the purposes of Section 2(22) of the Act. This view is fortified by the decisions of the Calcutta High Court in the case *CIT vs. Shree Balaji Glass Manufacturing Co. Ltd. 386 ITR 128, CIT vs. Mahesh Chandra Mantri 234 Taxman 158* and also by the decision of the Delhi Tribunal in the case of *DCIT vs. Maipo Ltd. 24 SOT 42.*

In the cases of amalgamation where the profits of the amalgamating company become the profits of the amalgamated company, a question came up as to whether such profits can be considered as accumulated profits in the hands of the amalgamated company when dividend was declared. It was held in the negative by the Ahmedabad Bench of the Tribunal in the case of *ACIT vs. Gautam Sarabhai Trust No.23 81 ITD 677 (Ahd ITAT)* wherein, the Tribunal succinctly captured the underlying principles concerning the computation of accumulated profits as under:–

(a) Section 2(22) introduces legal fiction and would necessarily receive strict interpretation.

(b) The expression "accumulated profits" used in the section would be construed as commercial profits computed in accordance with principles of commercial accounting. These profits are not to be treated as equivalent to assessable income.

(c) Capital gains chargeable under section 45 would be includible as part of the accumulated profits.

(d) If there is a provision in the constitution of the company against distribution of dividend out of capital profits, such profits would not form part of accumulated profits unless charged to capital gains tax.

(e) Surplus arisen on the amalgamation of companies would not result in revenue gain since amalgamation even if treated as an activity of purchase would not result in profit to the amalgamated company.

(f) Since amalgamating company is a separate entity, profits in its balance sheet, after amalgamation, cannot be treated as accumulated profits of the amalgamated company.

1.3 Accumulated profits on liquidation

On liquidation, generally, the funds available with the liquidator for the purpose of distribution would be a common fund and when payments are made to the shareholders out of such fund, there would not be any distinction between the payment made towards capital or profits. Even in such scenario, it is mandated that the accumulated profits till the date of commencement of liquidation be computed by the Official Liquidator to compute the dividend taxable under Section 2(22) of the Act. Therefore, as held in the case of *Kanhaiya Lal Bhargava vs. Official Liquidator, 56 ITR 393 (All HC)*, all profits earned until the date of commencement of liquidation is to be taken and not the profits after the liquidation proceedings has commenced and that the profits earned during the liquidation proceedings is not to be taken into account. Another difference in the wording in Section 2(22)(c) would be that the word "attributable" has been employed as, in a liquidator's account, as stated above, no distinction would be maintained between receipts on capital account and of profits. Hence the question arises as to how the accumulated profits is to be computed in such cases. In the decision of the Supreme Court in the case of *CIT vs. Girdhardas & Co. (P) Ltd. 63 ITR 300 (SC)*, it has been held that the amount distributed by the liquidator is deemed to be received as dividend in the proportion which the accumulated profits bear to the capital of the company i.e. the Assessing Officer has to determine the accumulated profits and rest of the capital before liquidation and then he has to adopt the ratio between such capital and the undistributed profits to the amount distributed to determine the component attributable to accumulated profits and that *"there is no warrant for the view that in the course of liquidation the accumulated profits exist as a separate fund even in a notional sense. Each distribution is of a consolidated amount which represents both capital and accumulated profits. There is also nothing in the clause which supports the view that whatever is brought to tax by the taxing authorities in a given year is dividend, and the rest represents the assets of the company. The fund in the hands of the liquidator is one: when the fund or a part of it is distributed, the distribution is deemed to take place in the same proportion in which the capital and accumulated profits stood in the accounts of the company immediately before the winding up."*

The latter part of *Explanation 2* to Section 2(22) also clarifies that in the case of liquidation consequent to the compulsory acquisition of the company's undertaking, any distribution out of accumulated profits of a period prior to three successive previous years immediately preceding the year of acquisition is not taxable as dividend.

2. Accumulated profits as on which date?

As already discussed above, under the 1922 Act, the settled position was that the accumulated profits were to be computed excluding the current profits i.e. it is only the previous years profits which were to be taken into consideration. However, with the insertion of *Explanation 2* to Section 2(22) under the 1961 Act, it is now clear that the accumulated profits shall be computed on the date of distribution or payment in so far as dividends under clauses (a), (b), (d) and (e) of section 2(22) and insofar as clause (c) of section 2(22) is concerned, till the date of liquidation. A view that as the financials are prepared at the end of every year and that the profits of the year are ascertained at the end of the year and therefore, the profits as at the end of the year has to be taken into account is not correct. When the distribution or the payment takes place in the middle of the year, the profits of the current year till the date of such distribution or payment has to be computed to ascertain the extent of dividend that can be taxed even though there is no statutory obligation to prepare the financial statements under the Companies Act.

3. Assessee's share of accumulated profits

It is a well-known position under the Companies Act that the assessee's share in the profits of the company is limited only to the extent of his shareholding. Like wise, under the Income-tax Act, it follows that the addition on account of dividend is to be restricted to the extent of the accumulated profits of the company attributable to the share of the shareholder to whom the distribution/payment is made and not the entire accumulated profits. It can be illustrated by the following examples:

(a) % holding of shareholder A = 5%

(b) Value of asset distributed by the company = ₹ 10 lakh

(c) Accumulated profit of the company as on the date of distribution = ₹ 15 lakh

(d) Amount of accumulated profit attributable to the shareholding of the assessee} = ₹ 15 lakh* 5% = ₹ 75,000

(e) Amount of dividend that can be assessed u/s. 2(22)(a) = Lesser of (b) and (d) = ₹ 75,000

The above principle has been upheld in the decision of the Pune Bench of the Tribunal in the case of *Kewalkumar Jain vs. ACIT – 144 ITD 672 (Pune ITAT).*

4. Whether accumulated profits assessed earlier are to be included in subsequent distributions?

Another issue that has to be considered is if the dividend is assessed earlier, whether accumulated profits to that extent has to be reduced while computing the liability in a subsequent distribution/payment. The answer is in the affirmative as accumulated profit to the extent of dividend that was assessed earlier should not be taxed again and therefore, when, for any instance, the accumulated profit is to be computed subsequently, the amount of dividend assessed earlier has to be reduced and the resultant amount would be the accumulated profit which has to be considered for the purpose of assessment of dividend under Section 2(22). The following illustration would make the point clear:–

Year 1

Amount distributed to Shareholder A (assuming he owns 100%) = ₹ 1,00,000

Accumulated profit as on the date of distribution = ₹ 60,000

Dividend assessable in Year 1 under Sec. 2(22)(a) = ₹ 60,000

Year 2

Amount distributed to Shareholder A = ₹ 1,50,000

Accumulated profit as on the date of distribution = ₹ 1,30,000

Accumulated profit to be considered for assessment = ₹ 1,30,000 – ₹ 60,000 (dividend assessed in Year 1)

= ₹ 70,000

Dividend assessable in Year 2 = ₹ 70,000 (lower of accumulated profit and amount distributed)

This question came up for consideration before the Supreme Court in the case of *CIT vs. G. Narasimhan 236 ITR 327 (SC)* wherein it was held that the amount assessed as deemed dividends in the earlier instances will have to be adjusted against the accumulated profits for the purposes of computation of accumulated profits in the subsequent instance when a loan or advance is granted.

5. "Whether capitalised or not" – What it implies?

On the reading of the provisions of section 2(22), one would come across the term *"to the* *extent of accumulated profits, whether capitalised or not…"*. Capitalisation of profits is an instance where the retained earnings of the company is converted to capital and to that extent shares being issued to the existing shareholders viz. bonus shares. Section 2(22) contemplates that for the computation of accumulated profits, even those profits which are capitalised are to be taken into account. The fact that such profits are no longer a part of the reserves/profit and loss account in the books of the company is not a relevant factor. The main objective of this is to discourage the practise of companies to reduce the accumulated profits by capitalising them and thereby, negating the liability to pay tax on the dividends distributed as contemplated under the section. It is wrong to assume that such capitalisation would be treated as dividend, unless it entails the release of the assets of the company. For example, issue of bonus ordinary or preference shares by capitalising the profits does not attract the provisions of Section 2(22)(a). However, on the redemption of such preference shares, as there is a release of the assets of the company, a view has been taken in the decision of *Shashibala vs. CIT 54 ITR 478 (Guj. HC)* that such redemption would be taxed as deemed dividend. However, in my opinion, such a view is not tenable as, at the time of redemption, it is by virtue of a pre-existing right to receive the proceeds of redemption that they receive the assets from the company and not on account of the decision of the directors to distribute the profits of the company as dividend. It cannot be tantamount to distribution of accumulated profits by virtue of shareholding, rather it is a distribution on the redemption of shares and therefore, stands on a different footing. However, before an issue of bonus shares, if a choice is given to the shareholder to either distribute cash out of the accumulated profits or allot bonus shares out of the same and the shareholder chooses the former, the same would be subject to tax under Section 2(22) as against the latter. The purport of "whether capitalised or not" is only that even after such capitalisation, the same has to be included in accumulated profits but not when a distribution is made out of it.

6. Duty of the Assessing Officer

The Assessing Officer, while making an addition under Section 2(22) of the Act has to satisfy himself about the existence of accumulated profit on the date of distribution or payment and ascertain the same and only if such accumulated profit is more than the distribution/payment, can such addition be made. If such accumulated profit is less than the distribution/payment, then the addition has to be restricted only to the extent of accumulated profit so ascertained. If there is no finding in the Assessment Order as regards to the existence of accumulated profits, the addition cannot be sustained. The same would hold good for every distribution/payment made during the year and in such instances, he is duty bound to ascertain the accumulated profits as on each date of distribution/payment and the dividend assessed for an earlier distribution/payment has to be reduced in the later instance.

Each work has to pass through these stages — ridicule, opposition, and then acceptance.

Those who think ahead of their time are sure to be misunderstood.

— *Swami Vivekananda*

CA Devendra Jain

Dividend – Sections 2(22)(a) and 2(22)(b) of the Income-tax Act, 1961

1. Introduction

The definition of income u/s. 2(24) includes, among other things, dividend under sub-clause (ii). The term dividend, in turn, is defined inclusively in clause (22) of Section 2. The said clause (22) contains five sub-clauses (a) to (e). The scope of this article is restricted to sub-clause (a) and sub-clause (b), though due to overlapping, certain points considered herein may also appear in other articles. Further, there is a dedicated article on the concept of 'Accumulated Profits' which is common to all the sub-clauses (except with some modification at certain places). Hence, the said concept is not dealt with in this article.

2. Scope of the term Dividend

a) What is the general meaning of term 'Dividend'?

The term 'Dividend' has been inclusively defined u/s. 2(22) of the Income-tax Act,1961. Therefore, the expression 'dividend' would mean dividend as ordinarily understood under the Companies Act, and also the head of payment or distribution specified in various sub-clauses of clause (22) of section 2.

[See Hari Prasad Jayantilal & Co. vs. V.S. Gupta, ITO[1966] 59 ITR 794 (SC)]

b) Can a receipt which does not fall under statuary definition of 'dividend' may be included for the purpose of Section 2(22) of the Income-tax Act, 1961?

The definition of dividend is an inclusive definition and a receipt by a shareholder which does not fall within the definition, may possibly be regarded as 'dividend' within the meaning of the Act unless the context negatives that view.

[See CIT vs. Nalin Behari Lall Singha [1969] 74 ITR 849 (SC).

3. Sub-clause (a) of clause (22) of Section 22

Following are the ingredients of sub-caluse (a):

1. There is a **distribution** by a company,
2. Of **accumulated profits** (whether capitalized or not),
3. Such distribution entails the **release by the company of** all or any part of the **assets of the company,**
4. Such distribution is to its **shareholders**.

Each of the above ingredients are explained below:–

3.1 Distribution by a company

This clause does not differentiate between a closely held company and a widely held company. Distribution by any kind of company may fall in this clause if it fulfils the other conditions.

Further, the clause lays emphasis on expression 'distribution' which in general sense means sharing something out among a number of recipients.

The following are the some of the propositions on the expression 'distribution'.

1. The dictionary meaning of the expression 'distribution' is **'to give each a share, to give to several persons'**. Thus it can be inferred that distribution would involve more than one recipient. Payment made to a single person would not constitute distribution. The only difference between the expression 'paid' and the expression 'distribution' is that the latter necessarily involves the idea of division between several persons which is the same as payment to several persons. Distribution is a culmination of a process.

   The expression 'distribution' connotes something actual and not notional.

   Distribution can be physical as well as it can also be constructive. One may distribute amounts between different shareholders either by crediting the amount due to each one of them in their respective accounts or by actually paying to each one of them the amount due to him. *[See Punjab Distilling Industries Ltd. vs. CIT [1965] 57 ITR 1 (SC)]*

2. The expressions 'distribution' and 'payment' connote different meanings; **distribution is division amongst several persons.** It connotes an idea of apportionment among more than one person. **In the case of 'distribution' the recipients would be more than one, while in the case of 'payment' the recipient may be a single person.** [See *CIT vs. P.V. John [1990] 52 Taxman 221 (Ker.)*]

3. Distribution of dividend need not be always in cash; it may be distributed by delivery of profit or right having monetary value. Sub-clause (a) is very widely worded so as to include distribution of any assets of the company. [See *Kantilal Manilal vs. CIT [1961] 41 ITR 275 (SC)*]

4. If the distribution is in kind, a question arises as to what should be the value of such dividend distributed in form of assets? Whether the value should be taken as book value or the market value of such assets?

   In *CIT vs. Central India Industries Ltd. [1971] 82 ITR 555 (SC)*, the Hon'ble Supreme Court has contended that **when shares are distributed as dividend, amount of dividend should be taken to be the market value of those shares as on date on which person concerned becomes entitled to those shares;** the fact that shareholder retains them and does not sell them is irrelevant. It would be wrong to say that when shares are distributed as dividend, the person who receives them gets only their face value in terms of money. What he really receives is the market value of those shares as on the date he became entitled to those shares.

5. An incidental question would then arise as to the method of valuation of assets in such cases. In my view, the valuation should be based on the fair market value approach and the valuation rules 11U and 11UA should not be made applicable in such cases.

3.2 Accumulated profits whether capitalized or not

The concept of accumulated profits has been covered by a separate article in this issue of journal.

3.3 Distribution entailing release by the company of all or any part of the assets of the company

The said sub-clause specifically specifies that distribution should result into release of all or any part of assets of the company. If there is no release of assets, the said sub-clause does not apply.

The following are some instances which covers release of assets in different forms:

1. *Shantikumar D. Majithia vs. DCIT [2013] 22 ITR(T) 246 (Mumbai)*

Transferable occupancy rights of a flat given to shareholders by a company on perpetual basis subject to deposit of a meagre sum, are considered as dividend under section 2(22)(a) .

In the facts of the case, HPPL, a company, had constructed a building and had given occupancy rights of flats in said building to its shareholders. The assessee (one of the shareholders) got the occupancy right in perpetuity and assessee could transfer his occupancy rights of the premises under consideration by way of sale to a third party subject to condition that transferee was to deposit the required amount of interest free security deposit with company. The consideration to be received by the assessee on transfer of his occupancy right was not to be refunded to company. It was held that the said occupancy right of the premises allotted by company to assessee amounts to dividend under Section 2(22)(a).

2. *Issue of bonus shares as dividend*

<u>Issue of bonus equity shares:</u>

Issuing bonus equity shares to equity share holders does not result in release of assets to the shareholders. While issuing bonus shares, the accumulated Profits simply get converted into share capital of the company. Issue of bonus shares in no way alters the asset position of the company and hence it is not considered as dividend within the meaning of sub-clause (a).

<u>Issue of Redeemable Preference Shares as bonus</u>

However, if accumulated profits are capitalized and redeemable preference shares are issued as bonus to equity shareholders, then on redemption of such bonus preference shares there would certainly be release of assets in favour of the shareholders; such pay off of bonus share would be considered as dividend within the meaning of sub-clause (a).

However, the question which arises here is, at what point it would be considered as 'release of assets by the company', whether:

a. At the time of issue of such redeemable preference shares, or

b. At the time of redemption of such redeemable preference shares.

Generally at the time of issue of redeemable preference shares as bonus to equity share-holders there would not be release of assets of the company in any way. Only the part/whole of reserves and accumulated profits of the company would be transformed into preference share capital.

However, at the time of redemption of the said preference shares there is certainly an outflow of assets and thus it is at this point the condition of distribution entailing the release of assets of the company is satisfied. Thus the said distribution will be treated as dividend within the meaning of sub-clause (a) in the year of redemption of such preference shares.

[See *Shashibala Navnitlal vs. CIT [1964] 54 ITR 478 (Guj.)*]

In **A.A.R. No. 654 of 2004,** the question put forth before Hon'ble AAR was ***"Whether, when the applicant allots bonus redeemable preference shares to the existing equity shareholders****, any income would accrue to the non-resident equity* *shareholders being the allottees and therefore, the company is required to deduct tax at source?"*

The relevant extract of the ruling is produced below–

"..the assets of the company will not be released and the case would not fall within the scope of Section 2(22)(a). In the case of preference shares, one cannot conclude that there is a release of assets ***as the payment of amount to the shareholders can be done only at the time of redemption of the preference shares. Redemption of preference shares*** *is not a straitjacket transaction where the company can pay the amount to the shareholders. Before the shares are redeemed, the company should have transferred a matching amount to the Preference Shares Redemption Reserve account or the redemption is carried out of fresh issue of shares. Either of these situations is contingent. In view thereof, it is submitted that there is no release of assets at the time of allotment of bonus preference shares and hence, it cannot be covered under the above sub-clause.*

It has, therefore, been submitted that ***mere issue of redeemable bonus preference shares would not tantamount to payment of dividends unless these shares are redeemed by the company. Only at that stage there will be release of assets of the company to the shareholders ….."***

It is important to note that the above discussion of issuing bonus shares as dividend will only be relevant in case of bonus to the EQUITY SHAREHOLDERS of the company. Issuing bonus shares to PREFRENCE SHAREHOLDER is specifically included in the definition of dividend *vide* sub-clause (b) of clause (22) of Section 22, the same is discussed later.

3.4 Distribution is to its 'shareholders'

The term "Shareholder" has neither been defined in Companies Act, 2013 nor in the Companies Act, 1956, however the term "Member" is defined u/s. 2(55) of Companies Act, 2013, which is a term wider than 'shareholder'. As per Section 2(55), which defines the term 'Member' states the following in sub-clause (iii)– "every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository". Section 2(22) of Income-tax Act refers to the term "Shareholders" and not 'members'.

Unless otherwise specified, the term 'Shareholders' would also include 'Preference Shareholders'

The word shareholder used in section 2(22) can only mean a registered shareholder. It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a "shareholder". He may be beneficially entitled to the shares but he is certainly not a "shareholder". [See *Rameshwarlal Sanwarmal vs. CIT (1980) 122 ITR 1 (SC)*]

Thus, any distribution by a company to a person who is beneficial owner of shares but is not a registered shareholder, will not be considered as dividend within the meaning of sub-clause (a).

4. Sub-clause (b) of clause (22) of Section 2

The above clause can be brokened up in following:

1. Distribution of debentures, debenture-stock, or deposit certificates in any form, with or without interest, to its shareholder.
2. Distribution of **bonus shares to preference shareholder.**

The above will be restricted to the amount of accumulated profits with the company whether capitalised or not?

In above case the distribution need not entail release of assets of the company as it is required u/s. 2(22)(a).

4.1 Issue of debentures etc.

When a company issues debentures, debenture-stock, or deposit certificates in any form, whether interest bearing or not to its shareholders (Equity or Preference), then such distribution will be considered as dividend u/s. 2(22)(b). This clause is specific and it only talks about distribution of debt instrument being debentures, debenture-stock, or deposit certificates in any form. Such an issue of debt instrument will not result in any immediate release of assets of the company and hence it will not fall within the meaning of sub-clause (a). Therefore, it has been specifically included in sub-clause (b) which does not contain any condition as to release of assets of the company.

4.2 Issue of bonus to preference shareholders

The second part of this clause is directly applicable when in case **Bonus shares are distributed to preference shareholder.** Such bonus share can either be in form of equity shares or preference shares. Both of them would be covered under this clause. As discussed above, this clause does not require release of assets of the company as it is required u/s. 2(22)(a).

It should be noted that distribution of bonus shares to Equity Shareholder is not specifically covered by Section 2(22)(b), however if one contends that such distribution will be covered by sub-clause (a) of clause (22) then, the decision of *Shashibala Navnitlal vs. CIT [1964] 54 ITR 478 (Guj.)* can be applied where it has been held that Issuing bonus equity shares to equity shareholders does not result in release of assets to the shareholders and hence it is not covered by sub-clause (a). In the result, issue of bonus shares to equity shareholders, neither falls under sub-clause (a) nor under sub-clause (b). However, as already discussed, if bonus redeemable preference shares are issued as bonus shares, it will fall under sub-clause (a) in the year of redemption.

5. Other issues

5.1 Taxability

Dividend falling under sub-clause (a) and sub-clause (b) will be liable for payment of Distribution tax by the company u/s. 115-O. In the hands of the shareholder, it will be exempt u/s. 10(34). However, if it fall under the newly inserted Section 115BBDA, there will no exemption u/s. 10(34) only up to the extent of ₹ 10 lakhs and it shall be again liable to tax at the rate of 10% in excess of ₹ 10 lakhs in the hands of shareholder. A separate article in this issue of the journal covers this topic in detail.

5.2 Subsequent transfer of assets acquired in form of dividend

The tax implication of subsequent transfer of the asset which is received as dividend depends upon the treatment of the said asset in the books of the shareholders.

For instance, if a shareholder receives a residential property as dividend and he treats the same as capital asset, on subsequent transfer the provisions of capital gains will get attracted.

However, if the shareholder is a developer (realty sector) and he treats the said property as stock-in-trade, the gain/loss on subsequent transfer will attract business profits. In both the cases, the market value of the asset which has been considered as dividend u/s 2(22) should be considered as the cost of acquisition, though there is no express provision for the same.

5.3 Subsequent transfer of bonus shares received as dividend by the shareholder.

When an equity shareholder receives equity shares as bonus shares then the same is not considered as dividend as held in case of *Shashibala Navnitlal vs. CIT [1964] 54 ITR 478 (Guj.).* The cost of acquisition of such shares shall be NIL, and on transfer of such shares the provisions of capital gain or business profit may apply as the case may be.

However, when an equity shareholder receives redeemable preference shares as bonus, the same will be considered as dividend as per sub-clause (b) of clause (22) of section 2, at the time of redemption – to the extent of accumulated profits, following the ratio laid down in *Shashibala Navnitlal vs. CIT [1964] 54 ITR 478 (Guj.).* This is in case the said redeemable preference shares are held till maturity. Any surplus above the accumulated profits will be chargeable as capital gains or business profits as the case may be.

If in case the redeemable preference shares are not held till maturity and are transferred, then, the gains on such transfer will be liable to tax either as capital gains or business profits, as the case may be. However the taxability on redemption for the new owner is a matter of concern as on redemption the amount which he will receive will be considered as dividend to the extent of accumulated profits (as redemption entails release of assets of company as held in *Shashibala Navnitlal vs. CIT [1964] 54 ITR 478 (Guj.)).* If the new owner receives any amount higher than the accumulated profits, surplus above the accumulated profits will be chargeable as capital gains or business profits as the case may be and he will be able to claim the purchase cost of the preference shares as a deduction.

5.4 Whether amount disallowed u/s. 36(1)(ii) can be considered as dividend?

Bonus or Commission paid to an employee is allowable as deduction subject to the condition that the amount payable to employees as bonus or commission should not otherwise have been payable to them as profit or dividend. The plain reading of the clause means that the profit of a business will not be allowed to be distributed by merely describing the payment as bonus or commission, if the payment is in lieu of dividend or profit. Disallowance u/s. 36(1)(ii) will be attracted in case when bonus or commission is paid in lieu of profit or dividend

[See *Loyal Motor Services Co. Ltd vs. CIT [1946] ITR 647 (Bom.)*]

In case of *'Dalal Broacha Stock Broking vs. Additional Commissioner of Income Tax, Mumbai' – (2011) 10 ITR (Trib.) 357 (Mumbai) (SB),* the assessee company was a closely held company which had paid exorbitant commission to its directors, who were also its shareholders, **the same was held to be commission in nature of dividend and was disallowed.**

In such cases of disallowance, a question arises whether such bonus or commission can be considered as dividend within the meaning of Section 2(22)(a). Ostensibly, it is still a bonus or commission, though has been disallowed u/s. 36(1)(ii). But the reason for disallowance is that such bonus or commission would have been otherwise payable as profits or dividend and therefore a harmonious interpretation will result into such payment of bonus or commission be treated as dividend u/s. 2(22)(a) and hence liable to DDT u/s. 115-O.

> Do not believe in a thing because you have read about it in a book. Do not believe in a thing because another man has said it was true. Do not believe in words because they are hallowed by tradition. Find out the truth for yourself. Reason it out. That is realization.
>
> —*Swami Vivekananda*


Bhairav Dalal
Ajay Kumar Ramchandran

Deemed Dividend u/s. 2(22) Clauses (c) & (d)

Introduction to Dividend

With the growth in the Indian economy, significant investments are pouring in as capital in a Company. Investors would be expecting returns on their capital invested in such company. In a corporate structure, distribution of profits by the company to its shareholders, in connection with their investment in shares of the company, is termed as Dividend.

Distributions can be in various forms (cash, stocks, etc.) as well as at various stages (i.e. during the routine course of operations (interim/final dividend); corporate actions (pursuant to capital reductions, buyback, etc.), final distribution (at the time of liquidation), etc.

Accordingly, it becomes pertinent to understand the Indian tax provisions with respect to such distribution, including determining the ambit of income and taxability in the hands of the company / shareholders.

Section 2(22) of the Income-tax Act, 1961 ('Act') provides the ambit of the term 'dividend'. This section has been further divided into sub-clauses (a) to (e) so as to cover the various types of distributions/payments made by the company to be included in the definition of dividend. Further, section 8 provides for charging of such dividend to tax in India.

In the ensuing paragraphs we have discussed the provisions of sections 2(22)(c) and 2(22)(d) of the Act, which deals with the distributions made by the company to its shareholders (i) on its liquidation and (ii) pursuant to capital reduction respectively.

Section 2(22)(c) of the Act: Distribution on liquidation

What is liquidation?

Liquidation is the process by which a company is brought to an end and its property is administered for the benefit of its creditors and shareholders.

Liquidation of a company, commonly referred to as 'winding up', is the process where the company's assets are realised with the resulting proceeds being used to pay off its debts and liabilities and thereafter, the surplus being distributed to its shareholders.

Reasons for winding up a company, *inter alia*, include corporate or financial restructuring of the group companies, insolvency, management deadlock, shareholders dispute and breach of statutory provisions. The company can be wound up by two modes viz. voluntarily or compulsorily. A compulsory winding up is initiated by the National Company Law Tribunal ('NCLT') on petition filed by the company / creditors /

Government, etc. Whereas, a voluntary winding up may be done by the members or the creditors of the company.

Legislative History

Section 2(22)(c) of the Act forms part of the Act since the time the Act was enacted (i.e. from the year 1961). There have been no amendments to section 2(22)(c) of the Act since the year 1961.

The definition of dividend in section 2(22)(c) of the Act, corresponds to that in section 2(6A)(c) of the Income-tax Act, 1922 ('the 1922 Act').

Section 2(6A)(c) of the 1922 Act was introduced in the statute in the year 1932 to remove the anomalous situation which arose out of the decision in the case of *Inland Revenue Commissioners vs. George Burrell [(1924) 2 KB 52 = 9 Tax Cas 27]*, which laid down that upon liquidation of a company the distribution by the liquidator of the accumulated profits of the company was not dividend because once liquidation intervenes, there is no question of distribution of dividends, and all the assets of the company remaining after the discharge of its obligations constitute surplus divisible among the shareholders as capital.

To nullify the above decision, section 2(6A)(c) was introduced in the 1922 Act and thereafter, the same continued as section 2(22)(c) in the 1961 Act.

Extract of the provision

Section 2(22)(c) of the Act is reproduced below:

"(22) dividend includes –

…

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;

…."

Key tax implications under the Act

As per section 2(22)(c) of the Act, any distribution to the shareholders shall be regarded as dividend if the ***distribution*** is made ***on liquidation*** and such distribution is ***attributable to the accumulated profits*** of the company ***immediately before its liquidation***, whether ***capitalised or not.***

Accordingly, for section 2(22)(c) to get attracted, it is important that there must be:

1. A distribution to the shareholders;
2. Such distribution should be on liquidation;
3. Distribution must be attributable to the accumulated profits of the company immediately before its liquidation; and
4. The accumulated profits could be capitalised or not.

In order to understand the ambit of section 2(22)(c) of the Act, we have analysed each of the abovementioned trigger points in the following paragraphs.

Distribution to shareholders

The dictionary meaning of the expression 'distribution' is 'to give each a share, to give to several persons'.

Actual distribution vs. Notional distribution: 'The word 'distribution' has been analysed by the Supreme Court in the case of *Punjab Distilling Industries Ltd. vs. CIT [1965] 57 ITR 1 (SC)*. The Supreme Court has pronounced that the word 'distribution' used in Section 2(22) contemplates actual distribution and not notional distribution. Therefore, it is important that the amounts should be distributed between different shareholders either by:

- crediting the amount due to each one of them in their respective accounts or
- actually paying to each one of them the amount due.

A notional distribution of amounts not actually available with the liquidator is not construed as distribution for the purpose of section 2(22).

Distribution vs. Payments: For triggering section 2(22)(c), not all 'payments' to the shareholders could be construed as 'distribution'. The expressions 'distribution' and 'payment' have different meanings, distribution is division amongst several persons. It connotes an idea of apportionment among more than one person. In the case of distribution the recipients would be more than one, while in the case of 'payment' the recipients may be a single person. For this purpose, support can be drawn from the decision pronounced in the cases of *Punjab Distilling Industries Ltd. vs. CIT [1965] 57 ITR 1 (SC), CIT vs. Jamnadas Sriniwas (P.) Ltd. [1970] 76 ITR 656 (Cal.) / CIT vs. P.V. John [1990] 52 Taxman 221 (Ker.).*

In connection with this interpretation, one needs to be mindful that not all distributions ought to trigger the provisions of section 2(22)(c). For example, at the time of liquidation, company may pay to its creditors which also includes a shareholder. In such case, (i) there is a distribution; (ii) distribution is to a shareholder. At this juncture, it is important to ascertain the intent of legislature – i.e. to tax dividends or distributions or payments to shareholders related to their shareholding. As payment of dividend is related to and proportionate to the shares held by a shareholder, any payment to him unrelated to his shares ought not to be treated as dividend. For this purpose useful support can be drawn from the decision pronounced in the case of *Commissioner of Income Tax vs. A. Vimalan [1975] 98 ITR 529 (Mad.)*

Distribution on liquidation

In order to attract section 2(22)(c) of the Act, the distribution itself must be among the shareholders of the company on its liquidation. Now a question arises on how to interpret the term 'on liquidation' – Whether it refers to the date on which the company commences the liquidation process or the date on which the company / liquidator receives the order from the NCLT.

In the context of section 46(2) of the Act, the High Court of Gujarat in the case of *CIT vs. Jaykrishna Harivallabhdas [2000] 112 Taxman 683 (Guj.)* has pronounced that the words 'on liquidation' necessarily refers to the date on which the company is wound up or the winding up process is complete.

Whilst the above ruling was in the context of section 46(2), an analogy could be drawn in the context of section 2(22)(c) of the Act.

Attributable to the accumulated profits before its liquidation

The Courts have interpreted the word 'accumulated profits' in the context of section 2(22)(e) of the Act and section 2(6A)(e) of the 1922 Act. As per the judicial precedents, the word 'accumulated profits' means profits in commercial sense. It means the profit earned and accumulated whether over a number of years or in a single year. Accordingly, for the section to be triggered, the company ought to possess accumulated profits.

Explanation 2 to section 2(22) clarifies that the expression "accumulated profits" for the purpose of sub-clause (c) includes all profits 'up to the date of liquidation' of the company. Accordingly, the 'date of liquidation for determining the accumulated profits' needs to be ascertained – Whether the "date of commencement of the liquidation" or the "date of completion of the liquidation/before commencing distributions to shareholders".

In the case of *Kanhaiya Lal Bhargava* (supra), the Allahabad High Court observed that the expressions "preceding the date" and "immediately before" are interchangeable terms conveying the same idea. Further, the Supreme Court (in the case of in *Dhandhania Kedia & Co. vs. CIT [1959] 35 ITR 400)* interpreted the term "Preceding the date" to mean prior to commencement of the liquidation, the same meaning ought to hold good for the expression "immediately before".

Accumulated profits, whether capitalised or not

The provision widens the ambit of accumulated profits to include not only the profits appearing as Free Reserves but also the profits which have been capitalised.

The Supreme Court in the case of *Urmila Ramesh [1998] 96 Taxman 533 / 230 ITR 422 (SC)* evaluated and explained that the legislative intent of using the words 'whether capitalised or not' is to clarify that the profits which are deemed to be dividend would be those which were capable of being accumulated and which would also be capable of being capitalised. Accordingly, even if the company had issued bonus shares by capitalising its profits/free reserves, the same shall be counted towards accumulated profits for the purpose of the Act.

Distribution in case of no accumulated profits or in excess of accumulated profits

Ambit of dividend under section 2(22)(c) is restricted to the extent the distribution is attributable to accumulated profits. Accordingly, it needs to be analysed for situations where the company has 'no accumulated profits' or in case the distribution is in excess of accumulated profits.

As liquidation results in extinguishment of rights of the shareholder in the company, distribution of assets to them can be construed as transfer of capital asset. The Act covers such situations under section 46(1) of the Act.

As per section 46(1) of the Act, distribution of assets by a company on its liquidation, shall not be regarded as a transfer in the hands of the company for the purpose of section 45 of the Act. Such capital gains are chargeable to capital gains/loss in the hands of the shareholder who receives the assets by way of distribution from such company.

One may note that, while section 45 of the Act provides for taxability of gains arising on transfer of a capital asset, section 46 of the Act provides for taxability for all the assets received by a shareholder on its liquidation. The scope of section 46 also covers situations where other assets, such as stock-in-trade etc. is distributed to the shareholders.

In such a situation, capital gains can be computed based on consideration / distribution received by the shareholder, less the amount assessed as dividend under section 2(22)(c) less the cost of acquisition of such shares.

Now, a question arises what shall be the cost of acquisition where there is a successive distribution of assets to the shareholders by the liquidator. The Act does not specifically cover such a situation. However, in the case of *CIT vs. Inland Agencies (P.) Ltd. [1983] 143 ITR 186 (Mad.)* it has been held that the cost of acquisition as contemplated by section 48 of the Act would have to be considered only once at the time when the distribution is first subject to capital gains tax.

- In case the distribution is lesser than the cost of acquisition, then the computation shall result in capital loss, and such loss can be set off against any capital gains including further distribution made by the liquidator.
- On the other hand, in case of excess distribution over the cost, capital gains shall be chargeable to tax

Liquidator's liability on liquidation of company

On liquidation of a company, the liquidator plays an essential role and hence, it is important for this article to also discuss the obligations applicable to the liquidator.

As per section 178 of the Act, the appointed liquidator of the company should within 30 days after his appointment give notice of his appointment to the Assessing Officer who is entitled to assess the income of the company which is going into liquidation.

Post such application, the Tax Officer shall notify the amount of tax which is payable or likely to be payable by the company. Thereafter, the liquidator ought to set aside such amount before parting away with the assets of the company.

The only exceptions to the above condition are payment towards (i) tax dues; (ii) secured creditors whose debts under the law are senior to the debts due to Government on the date of liquidation; and (iii) reasonable cost and expenses for winding up of the company.

Any default of the liquidator shall make him personally liable for such tax dues.

In case, there are two or more liquidators of a company the obligations and liability shall be borne by all the liquidators jointly and severally.

Per the recommendation of the Joint Committee on the Insolvency and Bankruptcy Code, 2015, the provisions of section 178 of the Act shall not be applicable to liquidator appointed under that Code.

Section 2(22)(d) of the Act: Distribution on capital reduction

What is capital reduction?

Capital reduction is the process of decreasing a company's share capital in the following ways:

(a) Reduce the nominal amount of any share so as to leave less sum unpaid;

(b) Reduce the nominal amount of any shares by writing off or repaying the paid-up capital;

(c) Reducing the number of shares by extinguishing the existing liability on certain shares.

Legislative history of section 2(22)(d) of the Act

Section 2(22)(d) of the Act forms part of the Act since the time the Act was enacted (i.e. from the year 1961). There have been no amendments to section 2(22)(d) of the Act since the year 1961.

The purpose of section 2(22)(d) of the Act is to bring within the ambit of dividend, the payments made by distribution of assets or moneys of the company which can be taken to have come from the accumulated profits of the company.

The Act proposes to tax the distributions made by a company to its shareholders on reduction of its capital to the extent to which such company possesses accumulated profits.

Extract of section 2(22)(c) of the Act

The extract of the section is reproduced below:

"(22) dividend includes - ……..

(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not.

…"

In common parlance, return of capital to the shareholders should not have any tax implications either for the company that is reducing its share capital or for the shareholders who are receiving back a part of their investment. However, section 2(22)(d) of the Act, creates a fiction, where distributions made to the shareholders by the company on reduction of its capital, to the extent company possesses accumulated profits is deemed as dividend.

Key tax implications under the Act

Based on the plain reading of section 22(22)(d) of the Act, any distribution to the shareholders shall be regarded as dividend if the ***distribution*** is made ***on reduction of capital,*** to the extent to which the ***company possesses accumulated profits*** whether ***capitalised or not***

Thus, for Section 2(22)(d) to get attracted, it is important that there must be:

1) A distribution to its shareholders

2) On reduction of the share capital

3) To the extent the company possesses accumulated profits

4) Whether such accumulated profits have been capitalised or not

The terms 'distribution', 'accumulated profits' and 'capitalised or not' used in the section have already been analysed in the earlier paragraphs

The next important consideration is the date on which the accumulated profits of the company should be considered for the purpose of section 2(22)(d) of the Act. The Explanation to section 2(22) of the Act provides that for the purpose of sub-clause (d) the profits of the company up to the date of distribution is to be included in the accumulated profits. However, for the purpose of sub-clause (c) of section 2(22) the profits of the company up to the date of liquidation is to be included in the accumulated profits.

Hence, there is a thin line of difference for considering the date on which the accumulated profits of the company is to be considered where a company goes for capital reduction as compared to liquidation.

Once the amount of dividend is ascertained, the next important thing is the taxability of proceeds received in excess of accumulated profits.

There is no specific provision in the Act dealing with the taxability of consideration received by shareholders in excess of accumulated profits (whether capitalised or not). The said question has been dealt by the Supreme Court in the case of *CIT vs. G. Narasimhan (1999) (236 ITR 327).* In the said judgment the court relied on its earlier judgment pronounced in the case of *Kartikeya V. Sarabhai vs. CIT (1997) (228 ITR 163)* wherein the Court had observed that as a result of reduction in the face value of share, the share capital is reduced, the right of shareholder to the dividends and their right to share in the distribution of net assets upon liquidation, is extinguished proportionately to the extent of reduction in the capital. Therefore, the said extinguishment of right is to be considered as 'transfer' under section 2(47) of the Act and thus, chargeable to tax under the head 'Capital Gains'. However, in the aforementioned decision the Court did not consider the provisions of section 2(22)(d). This question was examined by the Court in *G. Narasimhan case* (supra) and held that any distribution which is made by a company on reduction of its share capital which can be correlated with company's accumulated profits (whether capitalised or not i.e. to the extent company possesses accumulated profits), shall be regarded as dividend in the hands of the tax payer and taxed accordingly. It is only when any distribution is made which is over and above the accumulated profits of the company (capitalised or not), the question of a capital gains in the hands of a shareholder arises. The Court reached to the conclusion that the amount distributed by a company on reduction of its share capital has two components: (i) distribution attributable to accumulated profits and (ii) distribution attributable to capital. The distributions to the extent to which the company possesses accumulated profits shall be taxable as dividend and the balance may be subject to tax as capital gains. The Supreme Court, for the purpose of computing capital gains, left it on the Tribunal as to how should the full value of consideration be determined for the property distributed by the company. Further, the Court held that the cost of acquisition should be that portion of the share that has been diminished.

Now another question arises, whether accumulated profits in respect of which DDT was paid under section 115-O, should be considered again at subsequent payment of dividend. This can be better understood by way of the following example:

Company A receives the approval from NCLT for capital reduction during the year. The balances lying in the Reserve & Surplus account pre-capital reduction and post-capital reduction have been tabulated below.

Reserves & Surplus	Balance pre capital reduction (Amount in INR)	Balance post capital reduction (Amount in INR)
Securities Premium	200	0
Profit and Loss account	100	100
General Reserves	10	10
Total	**310**	**110**

Notes:

- Payment of premium over share capital on Capital reduction – INR 200, adjusted.
- Amount on which DDT paid – INR 110 (balance in Profit and Loss account and General Reserve).
- DDT paid – INR 20
- Balance lying in the Profit and Loss account after payment of DDT – INR 90

Company A now proposes to declare and distribute dividend from the balance in its Profit and Loss account (i.e. INR 90).

Question: Would Company A be liable to pay DDT on the amount of ₹ 90 to be distributed to its shareholders?

In the instant case, DDT has already been paid on capital reduction to the extent of the accumulated profits possessed by the company. The accumulated profits on which DDT has already been paid should not be considered again at the subsequent event of distribution, declaration or payment.

A reference may be made to the judgment of Supreme Court in the case of *CIT vs. G. Narasimhan* (supra). In this case, it was held that *"If the payment under section 2(22)(e) is treated as deemed dividend and is required to be so treated to the extent that the company possesses accumulated profits, the logical conclusion is that this payment must be considered as adjusted against the company's accumulated profits to the extent that it is treated as deemed dividend while calculating the accumulated profit of the company. Whenever accumulated profits of the company are required to be determined, such an adjustment will have to be made."*

Hence, the accumulated profits in respect of which DDT was paid under section 115-O read with section 2(22)(d) of the Act, should not be considered again at the time of subsequent payment of dividend.

Section 50CA

As highlighted in the earlier paragraphs, distribution in excess of accumulated profits is treated as transfer of capital asset. In such a situation, it needs to be ascertained whether the provision of section 50CA shall get triggered?

As per section 50CA of the Act, if the shares of an unlisted company are transferred at value which is less than its fair market value ('FMV'), determined in accordance with Rule 11UAA of the Income-tax Rule 1962 ('the Rules'), then the FMV computed in accordance with Rule 11UAA shall be deemed to be the full value of consideration for the purpose of computing capital gains.

Applicability of this Section under various situations would require detailed examination e.g. capital reduction without payout, situations where no accumulated profit is distributed, etc.

Capital reduction with consideration vs. without consideration

As discussed above, capital reduction can be done by a company with distribution of assets / cash or without distribution of assets / cash. In a case, where the shareholders right in the company is reduced / extinguished by reducing the share capital of the company with simultaneous distribution of assets / cash to the shareholders, such reduction of capital is called capital reduction with consideration. However, where there are huge accumulated losses sitting in the balance sheet of the company, the company may resort to adjust the accumulated losses of the company against the share capital of the company and there may be no consideration paid to the shareholders, such reduction of share capital is called capital reduction without consideration.

Where the company does a capital reduction with consideration, it could trigger dividend / capital gains tax liability. However, in case of a capital reduction without consideration, there is no distribution of assets. In such a situation, whether the shareholders, who bear the loss on reduction of share capital, are entitled to claim the capital loss under the Act?

The aforesaid question has been examined by the Mumbai Tribunal in the case of *Bennett Coleman and Co. Ltd. vs. Additional Commissioner of Income-tax.*

Decision of Mumbai Tribunal in the case of Bennett Coleman and Co. Ltd

The Tribunal observed that when a company reduces the share capital, the shareholder's rights would not be affected because such loss belongs to the company and assessable in the hands of the company. The proportionate shareholding would still remain same and entitled to same proportion of asset and shareholder's interest is not affected.

In the aforementioned case, the Tribunal observed that:

1. The tax payer has not received any consideration for reduction of share capital.

Only the number of shares held by the tax payer was reduced and nothing has moved from the side of the company to the tax payer.

2. when transfer consists in extinguishment of a right of capital asset, there must be an element of consideration for such extinguishment, to be construed as a transfer eligible to capital gain tax. In order to attract capital gains tax, there must be a transfer as a result of which consideration is received by the tax payer or accruing to the tax payer as a result of the transfer. The computation mechanism would be wholly inapplicable to compute the profits or gains from such transfer.

Based on the above, the Tribunal held that loss arising on account of reduction in share capital cannot be subjected to the provisions of Section 45 read with Section 48 of the Act and accordingly, such loss is not allowable as capital loss. Such loss could be described as notional loss.

Exception to section 2(22)(c) and 2(22)(d) of the Act

Section 2(22) provides that dividend does not include distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets.

Preference shareholders generally, are not entitled to surplus assets in event of liquidation, they would only be entitled to return of their share money to the extent of amount paid-up on such shares. Sub-clause (c) as well as the sub-clause (d) do not apply when the distribution is to a preference shareholder.

The above exception applies only in respect of preference shares which have been issued for full cash consideration. On the other hand, if the shares have only partly paid up but the shareholder gets full nominal value of share from the liquidator, then the difference between the amount partly paid up and the full face value of shares could be considered as dividend.

Taxation of Dividend

Dividend distributed under section 2(22)(c) and 2(22)(d) shall be subject to Dividend Distribution Tax ('DDT') at the rate of 15%[1] in the hands of the Company and the same shall be exempt in the hands of shareholder under Section 10(34). This exemption is subject to an additional tax of 10%[2] under section 115BBDA, for dividend income in excess of INR 10 lakhs in hands of certain specified shareholders.

Conclusion

As can be seen from the comments and discussion on the case laws above, it is very important to analyse the applicability of the provisions of section 2(22)(c) and 2(22)(d) at the time of liquidation / capital reduction of company from the perspective of quantum of dividends, capital gains, etc. Further, shareholders need to appropriately consider the impact of the newly introduced sections 50CA and 115BBDA at the time of such distributions.

Note: Views expressed are personal to author. Article includes inputs from Prem Jain, Assistant Manager.

1 Excluding applicable surcharge and education cess

2 Excluding applicable surcharge and education cess

CA Sanjay R. Parikh

Deemed Dividend u/s. 2(22)(e) by way of loan or advance

Introduction

The word "income' is defined in section 2(24) and includes dividend. Clause (22) of Section 2 defines the term "Dividend" in an inclusive manner. It not only includes dividend in general parlance but also includes certain specific distributions/payments within its sweep. Clause (e) is one of the clauses whereby the payment of a loan or an advance by a company, not being a company in which the public are substantially interested, is considered to be dividend subject to certain conditions. The clause basically is an anti-abuse provision in as much as a loan or an advance given by a closely held company to a shareholder having substantial interest or to a concern in which such shareholder is having substantial interest, may be taxed as "deemed dividend". Such loan or advance can be taxed to the extent of accumulated profits of the company. A similar provision was also there in the 1922 Act in section 2(6A)(e).

<u>Intention behind insertion of provisions of Section 2(22)(e)</u>

Closely held companies, which are controlled by a small group of members, though having accumulated profits, would not distribute profits as dividends, as the dividend would be taxable in the hands of the shareholders. Instead of distributing the profits as dividends, companies would give loan or advance to the shareholder or to a concern in which such shareholders have substantial interest. This would result in the shareholders enjoying the profits of the company without paying any tax on the dividend. It was to plug this loophole that the provisions of taxing such loans or advances were enacted. The object of inserting clause (e) to section 2(22) has been discussed by the Hon'ble Supreme Court in the case of *Navnit Lal C. Javeri vs. K. K. Sen, AAC (1965) 56 ITR 198 (SC)* and later in various other decisions.

The Constitutional validity of the said provisions were challenged under the 1922 Act and the Hon'ble Supreme Court has in the case of *Navnit Lal C. Javeri vs. K. K. Sen, AAC (supra)* held the provisions to be Constitutionally valid.

As the provisions are deeming provisions, it has been held by the Hon'ble Supreme Court that the said provisions have to be strictly construed – *Tarulata Shyam vs. CIT (1977) 108 ITR 345 (SC); CIT vs. Sarathy Mudaliar (CP) (1972) 83 ITR 170 (SC)* and recently in *Gopal and Sons (HUF) vs. CIT (2017) 397 ITR 1 (SC).*

In this article, the provisions of Clause (e) of Section 2(22) are discussed in detail.

When applicable ?

For a loan or an advance to be considered as deemed dividend u/s. 2(22)(e), the following conditions are required to be satisfied:

(a) payment by a company, not being a company in which public are substantially interested;

(b) by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of voting power or

(c) loan or advance to any concern in which such shareholder is a member or a partner and in which he has substantial interest or

(d) any payment on behalf of or for the individual benefit of such shareholder.

The loan or advance would be deemed to be dividend to the extent to which the company possesses the accumulated profits.

Payment by a company

Under the first condition, a "payment" is required to be made by a company, not being a company in which the public are substantially interested. It may be appreciated that the clause uses in this word "payment" as against the word "distribution" in clauses (a), (b), (c) and (d). Accordingly, it is not necessary that the company should have distributed the dividend. Even if no dividend is distributed, but if an amount is paid, the clause will be applicable. However, where there is no payment but only a journal entry is passed, the provisions of clause (e) would not be applicable. In the case of *CIT vs. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.),* the company had made a provision for interest. It was held that it was not a payment and accordingly the provisions of section 2(22)(e) would not be applicable with respect to the provision.

Payment by a company in which public are not substantially interested

The payment should be by a company in which public are not substantially interested (hereinafter referred to as "closely held company"). Accordingly, the provisions of this clause will be applicable only in the case of closely held companies. Section 2(18) of the Act defines "a company in which public are substantially interested". As per the said definition, a Government Company or a company owned by the Reserve Bank of India or its subsidiaries, a company registered u/s. 25 of the Companies Act, mutual benefit finance companies, a listed company, etc. would be considered to be companies in which the public are substantially interested.

As per sub-clause (b) of clause (18), a company would be considered to be a company in which public are substantially interest if it is a company whose shares (not being share entitled to a fixed rate of dividend with or without a further rate in participating in profits) were listed on the last day of the relevant previous year. An issue would arise as to whether the provisions of section 2(22)(e) would be attracted in a case where the loan or advance was given when the company was a closely held company. However, the shares of the company were listed on the last day of the previous year. One view is that one has to see whether the company is a closely held company at the time of payment of loan or advance. As on the date on which loan or advance was given, the company was a closely held company, the provisions of section 2(22)(e) would be attracted. The other view is that the term "company in which the public are substantially interested" is defined in section 2(18). As per this definition, if the shares of the company are listed on the last day of the previous year, the company is not a closely held company. Accordingly, the provisions of section 2(22)(e) would not be applicable. In the opinion of the author, the provisions of section 2(22)(e) may not be applicable as the term "a company in which the public are substantially interest" used in section 2(22)(e) is as defined in section 2(18). Further, section 2(18) considers a company whose shares are listed, even on the last day of the previous year, as a "company in which public are substantially interested". Accordingly, the company paying the loan or advance would be a company in which public are substantially interested.

One more issue may arise and that is whether a foreign listed company, whose shares are listed on the Stock Exchange outside India, would be considered to be a company in which public are substantially interested. This has relevance as the definition of the company under clause (17) includes a body corporate incorporated by or under the laws of a country outside India. A perusal of clause (18), which defines "a company in which public are substantially interested", it appears that only if the shares are listed on a Stock Exchange in India, a company would be considered to be a company in which public are substantially interested. In such a case, a foreign company even though its shares are listed on a Stock Exchange outside India, would be considered to be a closely held company and any loan or advance given by such foreign company may be hit by the provisions of Section 2(22)(e). This would definitely be the position in the case of a company having its residence in a country with which India does not have a Double Taxation Avoidance Agreement. In a case where India has a Double Taxation Avoidance Agreement and the Double Taxation Avoidance Agreement has a "non-discrimination" clause, it may be possible for the company to contend that by virtue of the non discrimination clause, if the shares are listed outside India, it should also be regarded as a company in which public are substantially interested. Accordingly, the loan or advance given by such a company should not be regarded as deemed dividend u/s. 2(22)(e).

Payment by way of advance or loan to a shareholder, being a beneficial owner of shares holding not less than 10% of voting power

The payment should be by way of advance or loan to a shareholder, being a person who is a beneficial owner of shares holding not less than 10% of voting power. One of the conditions is that the loan or advance is to a shareholder being a person who is a beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profit) holding not less than 10% of the voting power. Accordingly, all the three conditions i.e. shareholder, beneficial owner and holding not less than 10% of the voting power have to be simultaneously fulfilled. Accordingly, if a person is a registered shareholder but not the beneficial owner, then the provisions of this clause will not apply. Similarly, if the advance is received by the beneficial owner who is not a registered shareholder, even then, the provisions will not be applicable. If a shareholder is both registered shareholder as well as beneficial owner, the provisions of the clause will apply only if he holds 10% or more of the voting powers of the company. This condition has to be applied *qua* shareholder and the cumulative shares held by all shareholders or family members cannot be aggregated.

The condition in this particular clause is that the advance or loan should be to a shareholder. If the shareholder is also a creditor or a supplier of goods and payment is made towards supply of goods, then the provisions of clause (e) would not be applicable. Reliance in this regard is placed on the following decisions:

a) *CIT vs. Nagindas M. Kapadia (1989) 177 ITR 393 (Bom.)*

b) *CIT vs. Creative Dyeing and Printing P. Ltd. (2009) 318 ITR 476 (Del.)*

c) *CIT vs. I. P. India P. Ltd. (2012) 343 ITR 353 (Del.)*

d) *CIT vs. Alpex Exports Pvt. Ltd. (2014) 361 ITR 297 (Del.)*

In the case of *Nagindas M. Kapadia (1989) 177 ITR 393 (Bom.)*, the shareholder had a proprietary concern which had regular dealings with the company. The Hon'ble Tribunal had after analyzing the account, held that only a sum of ₹ 28,500/- in A.Y. 1968 – 69 and ₹ 10,000/- in A.Y. 1969-70 was a loan or advance. Rest of the payments were towards purchase of goods and hence could not be considered as deemed dividend u/s. 2(22)(e). The Hon'ble Bombay High Court has confirmed the said order.

The Hon'ble Bombay High Court has in the case of *Walchand & Co. Ltd. vs. CIT (1975) 100 ITR 598 (Bom)* held that even a temporary loan or advance would be hit by the provisions of section 2(22)(e).

Advance or loan in the ordinary course of its business

It has been specifically provided that an advance or loan made by a company in the ordinary course of business where lending is a substantial part of the business of the company is excluded from the provisions of deemed dividend. Accordingly, if a loan or advance is given by a non-banking finance company or a banking company, as lending is a substantial part of business, the loan or advance may not be considered to be deemed dividend.

An issue arose before the Hon'ble Bombay High Court in the case of *CIT vs. Parle Plastics Ltd. (supra)* as to what constitutes "substantial part of business". In the said case, the assessee apart from carrying on the business of manufacturing was also in the business of financing. The assessee had a loss from manufacturing and overall profit because of financing activity. The Hon'ble Bombay High Court held that any business which the company carries on which is not regarded as small, trivial or inconsequential as compared to the whole would constitute "substantial part of business". The Hon'ble High Court did not agree to the proposition that merely because the turnover or income was below a certain level, it could not be considered to be substantial part of business. The Hon'ble High Court held that various factors may be considered for deciding whether the business constitutes a substantial part of business, like turnover, profit, number of employees employed, etc. The Hon'ble High Court held that in absence of any yardstick in the form of percentage specified by the legislature, the same cannot be read into the section. Accordingly, it is not necessary that to constitute "substantial part of business" the business should have certain turnover or profit.

Loan or advance to any concern in which such shareholder is a member or a partner and in which he has substantial interest_

Finance Act, 1987 has extended the scope of section 2(22)(e) to cover even a loan or advance to any concern in which such shareholder is a member or a partner and in which he has substantial interest. Explanation 3 to section 2(22) defines the term "concern" to mean a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company. Clause (b) of Explanation 3 provides that a person shall be deemed to have a substantial interest in a concern other than a company, if he is, at any time during the previous year beneficially entitled to not less than 20% of the income of such concern. After the amendment to section 2(22)(e), department tried to tax the loan/advance in the hands of the concern receiving the loan or advance. The Hon'ble Special Bench of the Tribunal had in the case of *ACIT vs. Bhaumik Colour (P.) Ltd. (2009) 118 ITD 1 (Mum)(SB)* held that dividend could only be taxed in the hands of the shareholder. Accordingly, the addition made in the hands of the concern receiving the loan or advance was deleted. The said decision was affirmed by the Hon'ble Bombay High Court in *CIT vs. Universal Medicare P. Ltd. (2010) 324 ITR 263 (Bom.)* and subsequently in later decisions including the decision in the case of *CIT vs. Alfa Sai Minerals Pvt. Ltd. (2017) 398 ITR 660 (Bom.).* The said decision has been affirmed by the hon'ble Supreme Court in the case of *CIT vs. Madhur Housing and Development Company [Civil Appeal No. 1961 of 2013; Order dated 5th October, 2017].* The short decision of the Hon'ble Supreme Court affirms the decision of the *Hon'ble Delhi High Court in (2012) 340 ITR 14 (Del.)* wherein it has been held that the amendment does not extend the definition of "shareholder" to include a concern to which loan or advance was given. Accordingly, the loan or advance can only be taxed in the hands of a shareholder.

Decision in case of *Gopal and Sons (HUF) vs. CIT (2017) 391 ITR 1 (SC)*

Prior to the amendment of clause (e) to section 2(22), the position was well settled as regards a loan or advance given to a HUF. As HUF is not a legal entity and cannot hold shares in its own name, the shares were issued in the name of the Manager or Karta of HUF. As the shareholder was the karta and the beneficial owner was the HUF, it was held that a loan or advance given to the HUF could not be taxed in the hands of the HUF. Reference in this regard may be made to the decisions of the *Hon'ble Supreme Court in Rameshwarlal Sanwarlal (1980) 122 ITR 1 (SC)* and *C. P. Sarathy Mudaliar (1972) 83 ITR*

170 (SC). However, these decisions seem to have been unsettled by the Hon'ble Supreme Court in the case of Gopal and Sons (HUF) (supra).

The facts in the case of Gopal and Sons (HUF) were that the shares were registered in the name of its Karta i.e., Shri Gopal Kumar Sanei. The loan was given to the HUF after the amendment to clause (e). However, the company in its Annual Return filed with the Registrar of Companies, had shown the HUF as the shareholder along with the percentage of shares. The AO added the loan as deemed dividend in the hands of HUF.

As the company had in its return filed with the Registrar of Companies, had shown the Hindu undivided family as a shareholder holding substantial shares i.e., 37.12%, the Commissioner of Income-tax (Appeals) observed that a shareholder is a person whose name is recorded in the register of the shareholders maintained by the company and, therefore, it is the assessee, the Hindu undivided family, which was registered shareholder. The CIT(A) also observed that the only requirement is that the shareholder should be beneficial shareholder. He accordingly, upheld the addition.

The Hon'ble Tribunal relying on the decision in the case of *ITO vs. Binal Seventilal Koradia (HUF) (ITA No. 2900/Mum/2011, dated 10th October, 2012)* (the said decision followed the decisions of the Hon'ble Special Bench in the case of *Bhaumik Colour Pvt. Ltd. (supra),* the Hon'ble Rajasthan High Court in case of *Hotel Hill Top (2009) 313 ITR 116 (Raj.)* the Hon'ble Bombay High Court in case of *CIT vs. Universal Medicare Pvt. Ltd. (supra)),* deleted the addition.

Hon'ble High Court allowed the Department's appeal by observing that *"the assessee did not dispute that the karta is a member of Hindu undivided family which had taken the loan from the company and, therefore, the case is squarely within the provisions of section 2(22)(e) of the Income-tax Act."*

Before the Hon'ble Supreme Court, the question raised was as under :

"Whether in view of the settled principle that the Hindu Undivided Family cannot be a registered shareholder in a company and hence could not have been both registered and beneficial shareholder, loan/advances received by the Hindu Undivided Family could be deemed as dividend within the meaning of section 2(22)(e) of the Income-tax Act, 1961 especially in view of the term `concern' as defined in the section itself ?"

Before the Hon'ble Supreme Court, apparently the assessee seems to put forth various arguments. However, the Hon'ble Supreme Court seems to have decided the issue only on the basis of one argument, which seems to be the thrust of the assessee's argument i.e., the HUF was neither a registered shareholder nor a beneficial shareholder. Hence, the provisions of section 2(22)(e) are not applicable. This is evident from the following observations of the Hon'ble Supreme Court (para 5 on page 391) :

"… Though, this addition was questioned by the assessee on various grounds, we would take note of the submission which is advanced before us as the challenge is confined only on the basis of the said submission. The assessee had argued that being a Hindu undivided family, it was neither the beneficial shareholder nor the registered shareholder. It was further argued that the company had issued shares in the name of Shri Gopal Kumar Sanei, karta of the Hindu Undivided Family, and not in the name of the assessee/Hindu Undivided Family as shares could not be directly allotted to a Hindu Undivided Family. On that basis, it was submitted that provisions of section 2(22)(e) of the Act cannot be attracted."

It may be appreciated that there seems to be a fallacy in the argument of the assessee in as much as, though it was not a registered shareholder, it was definitely a beneficial holder of the shares as the dividend declared or income earned from the shares was to be benefit of the Hindu Undivided Family.

Reliance on behalf of the assessee was also placed on the decision of the Hon'ble Supreme Court in the case of *CIT vs. C. P. Sarathy Mudaliar (supra).*

The Hon'ble Supreme Court has noted that the provisions of section 2(22)(e) are deeming provisions and accordingly have to be strictly construed. The Hon'ble Supreme Court has also noted that if two views are possible, benefit shall accrue in the hands of the assessee. Thereafter, the Hon'ble Supreme Court read and analysed the provisions of section 2(22)(e) and Explanation 3 thereto. This is evident from the following paragraphs of the decision:

"13. A reading of clause (e) of section 2(22) of the Act makes it clear that three types of payments can be brought to tax as dividends in the hands of the shareholders. These are as follows :

(a) any payment of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to a share holder,

(b) any payment on behalf of a shareholder, and

(c) any payment for the individual benefit of a shareholder.

[See : L. Alagusundaran Chettiar vs. CIT [2001] 252 ITR 893 (SC).]

14. Certain conditions need to be fulfilled in order to attract tax under this clause. It is not necessary to stipulate other conditions. For our purposes, following conditions need to be fulfilled:

(a) Payment is to be made by way of advance or loan to any concern in which such shareholder is a member or a partner.

(b) In the said concern, such shareholder has a substantial interest.

(c) Such advance or loan should have been made after the 31st day of May, 1987.

15. Explanation 3(a) defines "concern" to mean Hindu Undivided Family or a firm or an association of persons or a body of individuals or a company. As per Explanation 3(b), a person shall be deemed to have a substantial interest in a Hindu Undivided Family if he is, at any time during the previous year, beneficially entitled to not less than 20 per cent of the income of such Hindu Undivided Family.

Thereafter, the Hon'ble Supreme Court has held as under :

"16. In the instant case, the payment in question is made to the assessee which is a Hindu Undivided Family. Shares are held by Shri Gopal Kumar Sanei, who is karta of this Hindu Undivided Family. The said karta is, undoubtedly, the member of Hindu Undivided Family. He also has substantial interest in the assessee/ Hindu Undivided Family, being its karta. It was not disputed that he was entitled to not less than 20 per cent. of the income of Hindu Undivided Family. In view of the aforesaid position, provisions of section 2(22)(e) of the Act get attracted and it is not even necessary to determine as to whether Hindu Undivided Family can, in law, be beneficial shareholder or registered shareholder in a company.

17. It is also found as a fact, from the audited annual return of the Company filed with the Registrar of Companies that the money towards shareholding in the company was given by the assessee/Hindu Undivided Family. Though, the share certificates were issued in the name of the karta, Shri Gopal Kumar Sanei, but in the annual returns, it is the Hindu Undivided Family which was shown as registered and beneficial shareholder. In any case, it cannot be doubted that it is the beneficial shareholder. Even if we presume that it is not a registered shareholder, as per the provisions of section 2(22)(e) of the Act, once the payment is received by the Hindu Undivided Family and shareholder (Mr. Sanei, karta, in this case) is a member of the said Hindu Undivided Family and he has substantial interest in the Hindu Undivided Family, the payment made to the Hindu Undivided Family shall constitute deemed dividend within the meaning of clause (e) of section 2(22) of the Act. This is the effect of Explanation 3 to the said section, as noticed above. Therefore, it is no gainsaying that since Hindu Undivided Family itself is not the registered shareholder, the provisions of deemed dividend are not attracted. For this reason, judgment in C. P. Sarathy Mudaliar, relied upon by the learned counsel for the appellant, will have no application. That was a judgment rendered in the context of section 2(6A)(e) of the Indian Income-tax Act, 1922 wherein there was no provision like Explanation 3.

18. We, thus, do not find any merit in this appeal, which is accordingly dismissed."

Although the attention of the Hon'ble Supreme Court was drawn to the decision of the hon'ble Supreme Court in C. P. Sarathy Mudaliar (supra), the Hon'ble Supreme Court has held that the said decision will have no application as the same was rendered in the context of section 2(6A)(e) of the Indian Income-tax Act, 1922 and there was no provision like Explanation 3. In this regard, it may be appreciated that Explanation 3 merely defines the term `concern' and `when a person shall be deemed to have a substantial interest in a concern, other than a company'. Explanation 3 does not shift the taxability of deemed dividend from shareholder to the recipient of loan or advance. That is still governed by the main provisions contained in clause (e) of section 2(22).

Further, though the Hon'ble Supreme Court has in paragraph 13 observed that a reading of clause (e) makes it clear that 3 types of **payments can be brought to tax as dividends in the hands of the shareholders**, the Hon'ble Supreme Court has thereafter held that as the payment has been made to the assessee, who has received the advance, and as the shares were held in the name of karta, who had a beneficial interest in the HUF, the provisions of section 2(22)(e) get attracted. Accordingly, with due respect, there seems to be a contradiction on the part of the Hon'ble Supreme Court inasmuch as in paragraph 13 it states that the payments can be brought to tax in the hands of the shareholders and thereafter in paragraph 17 it has held that as the payment has been received by the HUF, the payment made to HUF would constitute deemed dividend.

The Hon'ble Supreme Court has thereafter held that as the provisions of section 2(22)(e) get attracted, it is not necessary to determine as to whether HUF can in law be beneficial shareholder or registered shareholder in a company. Further, the fact that the annual return of the Company filed with ROC considered the HUF as shareholder also seems to have weighed with the hon'ble Supreme Court.

Whether decision of the Hon'ble Supreme Court in Madhur Housing and Development Company is contrary to Gopal and Sons (HUF) ?

It may be appreciated that the facts in both the cases i.e. Gopal and Sons (HUF) and Madhur Housing Development Company were different. In Gopal and Sons (HUF), the shares were purchased out of the funds of the HUF and were registered in the name of HUF and the loan was also given to the HUF. In Madhur Housing and Development Company, the loan was received by the company but the shares were held by a shareholder who had not only substantial interest in Madhur Housing and Development Company but also in the lender company. As the facts of the two decisions are different, in my opinion, the two decisions are not contrary to each other. Further, though the decision of the Hon'ble Supreme Court in Madhur Housing and Development Company was a later decision, it has not considered the earlier decision of Gopal and Sons (HUF). Further, both the decisions are of division benches.

What would be the impact of the decision of the Hon'ble Supreme Court in Gopal and Sons (HUF) ?

In my opinion, this decision may have impact only where the loan or advance is given to an HUF. Where loan or advance is given to a concern, which is neither a substantial shareholder nor a beneficial shareholder, but there are common shareholders who have beneficial interest in both the lender company and the receiver company, the decision of the hon'ble Supreme Court in Gopal and Sons (HUF) may not have any applicability and the position laid down by the earlier decisions i.e. of the Hon'ble Special Bench of the Tribunal in Bhaumik Colour Pvt. Ltd. (supra), decision of the Hon'ble Bombay High Court in case of *Universal Medicare Pvt. Ltd. (supra), etc.* would still hold the field. In fact, the Hon'ble Supreme Court has affirmed the said principle in *CIT vs. Madhur Housing and Development Company (supra)* by holding that the judgments are detailed judgment going into section 2(22)(e) which arrives at the correct construction of the said section and they do not wish to add anything to the judgment except to say that they agree therewith.

The Hon'ble Madras High Court has in the case of Principal *CIT vs. M/s. Ennore Cargo Container Terminal P. Ltd. [T. C. (A) Nos. 105 and 106 of 2017]* has considered the decision of the hon'ble Supreme Court in Gopal and Sons (HUF) (supra) and held that the said decision would not apply where the recipient of loan or advance was not a shareholder. In this regard, the Hon'ble Madras High Court has held as under :

"5.1 In our view, the question of law considered by the Supreme Court in the case of Gopal and Sons (supra) was different from the issue which arises in the present matter. The question of law which the Supreme Court was called upon to consider was whether loans and advances received by a HUF could be deemed dividend within the meaning of Section 2(22)(e) of the Act. The assessee in that case was the HUF and the payment in question was made to the HUF. The shares were held by the Karta of the HUF. It is in this context that the Supreme Court came to the conclusion that HUF was the beneficial shareholder.

5.2 In the instant case, however, both the registered and beneficial shareholders are two individuals and not the assesse-company. Therefore, in our view, the judgment of the Supreme Court does not rule on the issue which has come up for consideration in the instant matter.

6. Accordingly, in so far as Questions Nos. 3 and 4 are concerned, we find that no interference is called for with the view taken by the Tribunal via the impugned order. …"

The above decision of the hon'ble Madras High Court has been followed by the hon'ble Amritsar Tribunal in the case of *PMS Diesels vs. Addl. CIT (2017) 60 ITR (Trib) 466 (Amritsar).*

The Hon'ble Kolkata Bench of the Tribunal has also considered the decision of the Hon'ble Supreme Court in *Gopal and Sons (HUF) (supra)* in *DCIT vs. Hooghly Mills Co. Ltd. (2017) 50 CCH 127 Kol Trib* and in paragraph 7 held as under :

"7. The ld. DR submitted that the CIT(A) failed in not considering the combined voting power of the assesse and the assessee's subsidiary M/s. Hooghly Mills Projects Ltd. in M/s. Mega Resources Ltd. and in this regard placed reliance on the decision of the Hon'ble Supreme Court in the case of Gopal & Sons (HUF) vs. CIT 391 ITR 1 (SC). We have perused the above decision. In the aforesaid decision the question that was considered by the Hon'ble Supreme Court was as to whether when a karta of HUF is a shareholder in the lending company and when the lending company has given loans to HUF whether the holding of shares by the karta has to be considered as holding of shares by the HUF. The Hon'ble Supreme Court held that the karta is a member of the HUF and therefore the shareholding of the karta should be held to be on behalf of HUF. Therefore the conditions for applicability of provisions of section 2(22)(e) of the Act were attracted. We are of the view that the aforesaid decision has no application to the facts of the present case as the share holding of the assessee and the shareholding by its subsidiaries cannot be equated as to a case of share held by karta of an HUF in his capacity of HUF. …"

Accordingly, it appears that the decision of the Hon'ble Supreme Court in Gopal and Sons (HUF) (supra) may only be applicable in cases where the karta is holding shares on behalf of the HUF and a loan or advance is given to the HUF. It may not have universal application.

Subsequent set off of dividend distributed against loan or advance

If a loan or advance is given by a closely held company, which is considered to be deemed dividend in the hands of the shareholder, the clause provides that if the subsequent dividend is adjusted against the loan or advance, such adjustment would not constitute dividend in the hands of the shareholder. Accordingly, where a shareholder receives say ₹ 10,00,000/- as a loan from a closely held company, which is deemed to be dividend u/s. 2(22)(e) and thereafter if the company declares divided. The company adjust the dividend declared by it and payable to the shareholder against the loan earlier granted. In this case, the subsequent dividend would not be considered to be dividend. This seems to be on the principle that there cannot be double taxation of the same income. However, once the loan or advance is repaid, the question of any further set off would not arise and hence the subsequent distribution of dividend i.e., after the loan or advance is repaid, would be taxable – *L. P. Badiani vs. CIT (1985) 154 ITR 204 (Bom.).*

Accumulated profits

A separate article would be exhaustively dealing with this topic and hence, I do not intend to discuss the same in detail hereunder. However, in the context of clause (e), I would only like to bring out one point and i.e. that once a loan or advance is considered to be deemed dividend, its repayment would not go to add on to the profits. Accordingly, if a company has accumulated profits of say ₹ 10,00,000/- and it gives an advance to a substantial shareholder Mr. Z of ₹ 12,00,000/, its accumulated profits would become nil. If after Mr. Z repays the loan, if the company gives a fresh loan to Mr. X (also a substantial shareholder), as the accumulated profits have become nil, no amount can be added as deemed dividend in the hands of *Mr. X - Tata Iron & Steel Co. Ltd. vs. N. C. Upadhyaya (1974) 96 ITR 1 (Bom).* An issue may arise in case where the loan is set off against the dividend distributed. This is explained by way of an example. Say M/s. ABC Pvt. Ltd. has accumulated profits of ₹ 5,00,000/-. It gives a loan of ₹ 2,00,000/- to Mr. A (a substantial shareholder). Accordingly, the accumulated profits would now be ₹ 3,00,000/-. If M/s. ABC Pvt. Ltd. thereafter declares dividend of ₹ 3,00,000/- and adjusts the loan of ₹ 2,00,000/- against the dividend, if we reduce the deemed dividend of ₹ 2,00,000/- and also the actual dividend of ₹ 3,00,000/-, M/s. ABC Pvt. Ltd. would have no accumulated profits. However, the adjustment of ₹ 2,00,000/- is not considered to be dividend in the hands of the company as well as in the hands of the shareholder. Accordingly, the dividend of ₹ 2,00,000/- adjusted against the loan or advance, cannot go to further reduce the accumulated profits of the company.

Deemed Dividend u/s. 2(22)(e) vis-à-vis Advance Tax and TDS

Section 115O taxes the amount distributed as dividend in the hands of the company distributing the dividend. Accordingly, the dividend so paid after payment of the dividend distributed tax is exempt in the hands of the recipient. Explanation 2 – Chapter XII-D specifies that the expression "dividend" for the purpose of this Chapter shall have the same meaning as is given in clause (22) of Section 2 but shall not include sub-clause (e) thereof. Accordingly, the deemed dividend u/s. 2(22)(e) would not liable for dividend distribution tax. As the loan or advance which is paid, is not exempt from tax u/s. 10(34), the same would be liable to tax in the hands of the shareholder and consequentially the provisions of Advance Tax and TDS would be applicable.

As per Section 194, the Principal Officer of an Indian company or a company which has made the prescribed arrangement for the declaration of payment of dividend, is required to deduct tax on the dividend. The tax is required to be deducted at the rates in force. Similarly, Section 195 would be applicable if the dividend is paid to a non-resident. Accordingly, if any sum is paid as a loan or advance and which may be construed as deemed dividend, would be liable to TDS u/s. 194 or 195 of Income-tax Act. Failure to deduct tax would result in the payer being considered to be in default and consequentially exposing him to the provisions of Section 201(1), 201(1A) and 271C.

Section 209 provides for computation of advance tax. Since the dividend u/s. 2(22)(e) would be taxable in the hands of the shareholder, the shareholder will be liable to advance tax in the event the payer does not deduct tax from the loan or advance given. Failure to pay such advance tax would result in interest liability u/s. 234B and 234C of the Income-tax Act.

Conclusion

I thank The Chamber of Tax Consultants for giving me this opportunity to express my views on this topic of "deemed dividend". I also appreciate the organisers for preparing an exhaustive scope for this article.

CA Praful Poladia & CA Manisha F.

DDT u/s. 115-O

1. Background

Dividend plays an important role while making investment decisions and the tax impact on it also is equally vital. From investors' standpoint, dividend plays critical role in measuring return on investment, whereas for company distributing dividend, it entails additional tax in the form of dividend distribution tax (DDT). Prior to introduction of Section (S.)115-O in the Income-tax Act ('Act' or 'ITA'), India had classical system of dividend taxation whereby profit distributed (post taxes) by a company as dividend constituted chargeable income receipt in the hands of the shareholders. Dividend taxation regime has undergone numerous changes since its inception. This article analyses certain aspects of dividend taxation, specifically Section 115-O of the Act.

1.1 Introduction of Dividend-Distribution Tax – Provision in brief

As stated earlier, India had classical taxation wherein dividend was taxable in the hands of shareholder with the company distributing dividends was liable to withhold taxes on dividend. Additionally, it also entailed lot of paperwork in terms of company deducting and issuing tax deducted certificate, shareholders filing return declaring such income, claiming refund, if any etc. In order to overcome the above and reduce cost of collection and curb tax evasion through non-reporting of dividends by shareholders, Government introduced Section 115-O in the Act *vide* Finance Act, 1997.

As per S.115-O, any amount declared, distributed or paid by a domestic company to its shareholders, whether out of current or accumulated profits, will be subject to additional income tax, being tax on distributed profits. Colloquially, such tax is known as Dividend Distribution Tax ('DDT'). DDT is an additional Income-tax in respect of the income represented by distributed profits on the company distributing dividends. DDT is payable in respect of dividend on equity shares as well as preference shares.

The section presently provides for 15% tax on dividends distributed by a domestic company. After considering grossing up, surcharge and cess, the effective rate of Dividend Distribution Tax ('DDT') stands at approximately 20%. Such dividends are, however, exempt from tax in the hands of shareholders. In effect, every shareholder, irrespective of his effective tax rate, is indirectly taxed @ ~20% in respect of dividend income.

2. Analysis of S. 115-O

2.1 Meaning of the term Dividend

The term 'dividend' has been defined u/s. 115-O to include, any payment or distribution which constitutes dividend u/s. 2(22)(a) to (d). Accordingly, an amount which is considered as dividend within S. 2(22)(e) is outside the purview of this section.

As S. 2(22) is an inclusive definition and covers 'dividend', i.e. dividend as understood under Companies Act (whether paid as interim or final dividend or whether paid in violation of provisions of Companies Act), will continue to be considered as dividend triggering DDT liability.

Also, unlike interim and final dividend (regular dividend) trigger of deemed dividend is restricted to the quantum of accumulated profits as of the date of distribution. Scope of accumulated profits is a subject matter of separate article in the present publication.

2.2 Trigger of DDT liability

DDT is levied on amount of dividends 'declared', 'distributed' or 'paid' and is required to be paid to the Government within fourteen days from the date of declaration/distribution/ payment of any dividend, whichever is earlier.

The terms 'declared' and 'distributed' have not been defined under the Act and hence one will have to understand the same with the help of dictionary meanings. Broadly speaking, the term declaration and subsequent payment applies to final dividend declared at annual general meeting (AGM), the term "distribution" relates to items deemed to be dividend within the meaning S. 2(22)(a) to (d) of the Act and the term 'payment' is applicable in case of interim dividend.

The expression "whichever is earlier" should be interpreted to capture the earliest of the dates which appears to be applicable to the facts of the case. For example, in case of final dividend, declaration may be followed by payment; in case of deemed dividend, distribution may be followed by payment. In any such case, the earlier applicable date is required to be adopted. It would be incorrect to interpret to mean that it blurs the distinction between "declaration", "distribution", and "payment" for the purpose of chargeability of DDT.

Further, no DDT is payable on the amount of dividend waived by the promoters on an irrevocable basis prior to the date of declaration. However, if a company were to revoke dividend declared (if so permitted under the law), one will need to undertake a fact specific evaluation about applicability of DDT. It is interesting to note that interim dividend can be altered after declaration as the liability or debt towards shareholders ignites only on payment and not on declaration, accordingly withdrawal of interim dividend should not have adverse consequences.

Will dividend paid in kind, say in the form of car, watches, any other assets, stand on a different footing as compared to dividend which is paid in cash? How will one value the amount of dividend paid and corresponding DDT liability thereon? One may note that there is no bar on mode of dividend payment, either in cash or in kind and it is the prerogative of the company on how it wants to reward its shareholders. However, on payment of DDT when dividend is paid in kind there is no mechanism which is prescribed under Section 115-O. A plausible and practical way would be to determine the fair market value of the asset received in order to quantify the amount on which DDT is to be paid when dividend is paid in kind.

2.3 Who is liable to pay DDT

As per S.115-O every domestic company within meaning of S.2(22A) of the Act would be liable to pay DDT. As per this provision, domestic company includes Indian company or any other company, whose income is liable to tax under the Act and has made arrangements for declaration and payment of dividend (both equity and preference) within India, payable out of such income liable to tax in India.

The prescribed arrangements for declaration and payment of dividends within India is specified in Rule 27 of the Income Tax Rules, 1962 which states that–

- The share register of the company for all shareholders shall be regularly maintained at its principal place of business in India.
- General meeting shall be held only at a place within India
- Dividends declared shall be payable only within India to all shareholders.

The DDT liability is applicable in case of all domestic companies – whether it is a listed company or an unlisted company, including private limited or one person company (OPC) as may get incorporated under provisions of Cos Act, 2013. However, it is not applicable in case of foreign company, unless such foreign company meets with the requirement of being a domestic company by complying with the provisions of S. 2(22A) of the Act (i.e. arrangement for declaration and payment of dividend within India). Further, a foreign company may be regarded as resident of India by virtue of its Place of Effective Management (POEM) in India. Even in such cases the provisions of S. 115-O will not be applicable as a POEM resident foreign company is not regarded as domestic company and is only considered to be resident of India. To clarify, under ITA, DDT liability is not linked to residential status of a company, rather it is linked to the type of company, i.e. whether domestic company or otherwise. Unlike ITA, under draft DTC, 2013, all resident companies (including foreign companies which may trigger residence basis POEM in India) were proposed to be regarded as domestic company, liable to DDT.

The liability is not triggered in case of other incorporated entities such as Limited Liability partnership (LLP), Co-operative Society etc. Since LLP structure is, to a large extent, commercially comparable to structure of a company/body corporate, at times, the taxpayers find it to be more desirable to carry on business through the medium of LLP.

2.4 Is DDT a surrogate tax liability on dividend income of shareholders?

As discussed in earlier chapters, regime of dividend taxation has undergone change over period of time - from taxation in the hands of shareholder to current regime of taxation in the hands of company. One of the questions which has been debated and keeps surfacing is whether DDT is a tax on company or is a tax on shareholder. Can shareholder contend that they have borne the economic burden of tax through the instrumentality of DDT and hence tax consequences in their hands should arise as if dividend has actually suffered tax in their hands? Question assumes significance, since, if it is held that DDT is tax on shareholders, section 14A would not be applicable as the dividend income will no longer be regarded as exempt from tax. Further, such interpretation would pave way for application of dividend article in tax treaties in the hands of foreign shareholder and enable resident country to claim credit of DDT paid in India.

Supreme Court (SC) in the case of *Godrej & Boyce Manufacturing Company Ltd. [(2017) 81 taxmann. com 111]* has set to rest the above controversy and ruled that DDT is a liability of the company and not the shareholder. This decision was in the context of Section 14A and SC after reviewing scheme of dividend taxation since its inception, upheld applicability of section 14A and this clearly shifts the momentum against the shareholder.

2.5 Grossing-up – DDT rate

DDT is payable at the rate of 15% as increased by surcharge and cess. Under classical system of taxation, the shareholders used to pay tax on the amount of dividend received, whereas the company distributing dividends pays DDT on dividend, net of taxes. In order to bring parity, Finance Actm 2014 introduced sub-S.(1B) in S. 115-0. Post amendment, while the rate of tax remains unchanged to 15%; the rate of DDT is to be applied on the 'gross amount' of dividend payable.

Accordingly, the net distributable profits shall be increased to such amount as would, after reduction of tax on the increased amount at the rate of 15%, be equal to the net distributed profits. Effectively the impact of the amendment is an increase in the rate of DDT from 15% to 17.65% [100 / (1-0.15)-100]. With surcharge of 10% and education cess of 3%, effective rate increases from 16.995% (i.e., 15% plus surcharge and education cess) to 19.995%.

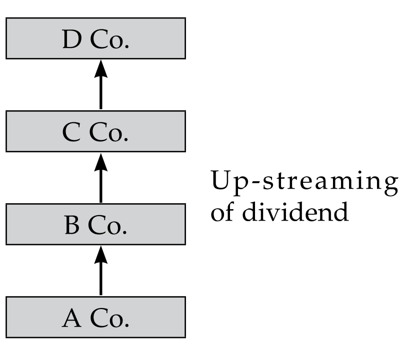
The concept of grossing-up is comparable to methodology applied in terms of S.195A of the Act and can be explained by means of the following illustration for rate of 15% of DDT:

Particulars	**Amount**	
Net distributable profits	A	100
Add: DDT quantum adjustment (i.e. grossing up) [100/(1.00-0.15)]-100]	B	17.65
Grossed-up amount (on which DDT is to be applied)	C (A+B)	117.65
Rate of DDT (15%)	D = C*15%	17.65
Net distributable profits	E=C-D	100

Thus, there is an additional tax outflow of approximately 3% for the dividend distributing company on same dividend amount in pre and post amendment scenario.

2.6 Roll over benefit

Consider a group wherein all entities are Indian (domestic) companies. The entities in lower tiers are 100% subsidiaries of its immediate parent. The payment of dividends would flow from A Co. to B Co. to C Co. to D Co.



A Co. declares and pays dividend to B Co. and also pays requisite DDT thereon under S.115-O of ITA. Subsequently, B Co. declares and distributes the same amount of dividend to C Co. which in turn declares and distributes to D Co.

Prior to introduction of S.115-O(1A), *vide* Finance Act, 2008, DDT was payable at each layer in a multi-tier structure on distribution or payment of dividend. With a view to provide relief from the cascading effect of DDT on up streaming of dividend, sub-section (1A) was introduced in S. 115-O. S 115-O(1A) to the extent relevant reads as below:

"(1A) The amount referred to in sub-section (1) shall be reduced by,—

(i) the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,—

(a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or

(b) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend:

***Provided** that the same amount of dividend shall not be taken into account for reduction more than once;"*

Basis the above provision, the following conditions are required to be fulfilled in order to be eligible for roll over benefit:

(i) Recipient company is a domestic company;

(ii) Such dividend is received from its subsidiary;

(iii) Such dividend is received during the financial year; and

(iv) The subsidiary has paid the DDT payable on such dividends under S. 115-O

Whilst section 115-O(1A) seeks to provide roll over relief by reducing dividend received from subsidiary (on which subsidiary has paid DDT) out of the total amount of dividend payable by parent company under Section 115-O(1), issue arises on the extent to which layer of subsidiary can DDT relief be provided.

As per one view, benefit of S.115-O(1A) works on the principle of pay-exempt-pay and benefit of exemption would be restricted to those dividends where DDT has been **paid** by the immediately preceding subsidiary. In this case, C Co. gets no benefit of exclusion in respect of dividend from B Co. as B Co. does not pay any DDT. This view is based on literal reading of section 115-O(1A)(a) which requires following two Conditions to be cumulatively met.

- Dividend is received from its subsidiary **and**
- The subsidiary has **paid** DDT payable under S. 115-O on such dividends

As per other view, subsidiary has paid tax 'which is payable' and hence rollover benefit is available to the second and all subsequent dividend pay-outs (i.e., no DDT is payable in the chain once DDT is paid at the level of A Co. if the amount distributed is same across). This view is based on legislative intent[1] which states that provisions were introduced to remove cascading effect of DDT in a multi-tier structure where dividend received by a domestic company from its subsidiary (which is also a domestic company) is distributed to its shareholders.

A view, not free from doubt, appears that roll over relief should be available to entire chain of subsidiary.

2.7 Timing of dividend receipt from subsidiary to claim rollover relief

Section 115-O(1A) requires reduction of dividend received from subsidiary to determine amount of dividend subject to DDT under section 115-O(1). Thus, issue arises whether rollover relief is available only if dividend from subsidiary precedes declaration of dividend by parent company. In other words, can benefit of rollover relief be denied if dividend from subsidiary is received-though in same financial year, but post date of declaration of dividend by parent?

Whilst a view not free from doubt, it appears that Section 115-O(1A) benefit should be available in respect of dividend which is received by parent company during financial year irrespective of whether such dividend preceded or succeeded the date on which the subsidiary declared dividend and triggered DDT liability. This view is based on following arguments:

- S. 115-O(1A)(i) makes reference 'to the amount of dividend received during the financial year'. It is a cardinal principle of law that statute must be interpreted such that no part of word is rendered surplus. Thus, due weightage is to be given to the expression "during the financial year"
- Payment of DDT with 14 days from applicable date stated in Section 115-O(1) is merely procedural section. Procedural

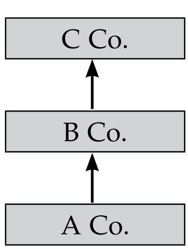
1 Circular No. 03/2013 explaining provisions of Finance Act 2012 section cannot oust operation of charging section.

- Section needs to be read liberally in a way which sub-serves the purpose of legislature and does not frustrate it.

It may be noted that default in DDT payment may invite severe consequence of levy of interest, penalty and prosecution. Thus, parent company should be certain about dividend receipt from subsidiary during the year. For taxpayers who do not wish to take risks, it may be advisable that parent company, on triggering of event, may pay up DDT and claim refund thereof once parent receives dividend from subsidiary later during the same financial year.

2.8 Holding – Subsidiary relationship for claiming rollover relief

As elaborated earlier, roll over benefit is available on dividend received from the subsidiary when the subsidiary has paid DDT payable on such dividend. Further, the liability to pay DDT is triggered by the company within 14 days of declaration, distribution or payment of dividend. The issue that arises is how one should evaluate the holding-subsidiary relationship as contemplated by the provisions. Whether the holding-subsidiary relation should subsist all throughout the financial year or only at the time of receipt of dividend and/ or at the time of up-streaming. To illustrate the controversy, let us consider following fact pattern.



B Co. declares dividend on 1st Aug. 2017

A Co declares dividend on 1st July, 2017

A Co. has declared dividend to B Co. on 1st July 2017 whereas B Co. has declared dividend to C Co. on 1st August 2017. A Co. has paid DDT as on 14th July 2017 and B Co. is contemplating payment of DDT as of 14th August, 2017. The issue is which is the date or period for which A Co. should be a subsidiary of B Co..

If relationship is subsisting all throughout the year, there may not be any concern on roll over benefit at the time of onward distribution.

In a situation wherein A Co. is subsidiary of B Co. only for a part of the period i.e., say A Co. is subsidiary of B Co. from 1st July, 2017 to 30th August, 2017. In this case as on the date of declaration by A Co./receipt of dividend by B Co. as also the date on which B Co. distributes dividend and respective companies determine and discharge DDT liability, the conditions of S. 115-O(1A) are fulfilled. Accordingly the same should not entail adverse consequences.

However the following scenarios are ambiguous and litigative to conclude that roll over benefit will be available –

Particulars
A Co. is B Co's subsidiary as of 1st July, 2017 but ceases to be a subsidiary on 5th July, 2017
A Co. is not B Co's subsidiary as of 1st July, 2017 but becomes subsidiary on 5th July, 2017 and continues to remain so, as on 14th August, 2017

2.9 Interplay between roll over benefit provisions and S. 115BBD

There can be situations where the group is a multinational group with subsidiaries outside India. Considering the fact pattern at para 2.6 above, and all other factors remaining constant, would life be different for the group if A Co. is a foreign Company?

Dividend received from a foreign subsidiary company is taxed at a concessional tax rate of 15% on gross basis under the Act (S. 115BBD). The benefit of reduced rate is available provided the Indian company holds **twenty six per cent** or more in nominal value of equity share capital of the foreign company. In order to remove the cascading effect in respect of dividends received by a domestic company from a similarly placed foreign subsidiary, the roll over benefit is also available in respect of dividend received from foreign company, on which taxes are paid by the Indian company. However, for availing benefit of roll over exemption, I Co. should hold more than 50% of equity capital of F Co. Accordingly, though the reduced rate of 15% on foreign dividends received is available if Indian company has 26% minimum nominal value holding in the foreign company, in order to be eligible for roll over benefit on further up-stream distribution by the Indian company, the Indian company should hold more than 50% of equity in the foreign company.

There may be situation where Indian Company may pay taxes under S. 115JB, i.e. Minimum Alternate Tax (MAT), on book profits including dividend received from foreign company and not specifically under S. 115BBD. Issue may arise whether roll over relief can still be claimed? Arguably, company should be entitled to. Admittedly, tax is payable under S. 115BBD but for mandate of S. 115JB. Implicit in payment u/s. 115JB is the payment of higher taxes which include taxes payable under 115BBD on dividend income.

In case of foreign dividends received, another interesting issue is whether claim of foreign tax credit on dividend received from foreign company impacts the rollover benefit of S. 115-O (1A). A possible view of the matter may be that claim of foreign tax credit is an alternative way of discharging tax liability and should not dilute or hamper the benefit.

2.10 Issues on merger

Interesting issues arise on dividend payment by subsidiary and on a later date merger of subsidiary is proposed with its holding company with retrospective appointed date, which nullifies the dividend transaction. Whether in such cases one can suggest that the dividend transaction was never undertaken and hence the subsidiary should not pay DDT or the DDT paid by the subsidiary should be refunded? What would happen if the merger scheme is not sanctioned by the court from a retrospective appointed date or the merger may not get sanctioned by the court? Though a view persists that if merger scheme is approved by the Court with a given appointed date, subsidiary ceases to exist as an independent entity in terms of assets, funds, business and activities, and hence, the payment of dividend during the intervening period (i.e. between appointed date and effective date) would be payment to self, one should also be mindful of the onerous penalty provisions, especially in cases where DDT is not paid and there hinges an uncertainty on sanction of merger scheme with the retrospective appointed date as specified. However, if DDT is already paid, merged company may be entitled to refund of DDT payment on cancellation of dividend transaction on merger.

2.11 Other issues of relevance

DDT and MAT: Dividend is below the line item in profit and loss account and is not a deductible expenditure for income tax purposes as well. Further, S. 115-O(5) specifically prohibits grant of any deduction to either the company or to the shareholder in respect of DDT liability. Additionally, Section 115JB also requires DDT to be added back if debited to profit and loss account while computing the book profits for MAT purposes.

Exclusions from applicability of DDT provisions

Previously, any undertaking engaged in developing /operating /maintaining a Special Economic Zone (SEZ) was not required to pay DDT on any dividends declared/paid/ distributed out of income earned in SEZ, however this exemption was curtailed from 1st June, 2011. Currently exemption from

DDT is provided to dividend paid by certain domestic companies to business trusts, unit of an International Financial Services Centre deriving income solely in convertible foreign exchange.

3. Procedural compliance for DDT

Below are procedural obligations cast on the company in relation to DDT:

- DDT should be paid to credit of Central Government within fourteen days from the date of
  - o Declaration of any dividend
  - o Distribution of any dividend
  - o Payment of any dividend

  whichever is earlier

- On failure to pay whole or part of DDT, within the time limit, the principal officer or the domestic company would be liable to pay simple interest under Section 115P at the rate of one per cent for every month or part thereof till the tax is actually paid. Further, the Principal Officer/company shall be treated as assessee in default under Section 115Q in respect of amount of tax payable and all the provisions on collection and recovery shall apply accordingly.

- **Penalty and Prosecution:**
  - o In addition to interest on late payment, Principal Officer/company may be made liable to penalty in terms of Section 271C unless there is a reasonable cause to prove otherwise.
  - o Subject to reasonable cause defence under Section 273B, the Principal Officer and any person in charge and was responsible to the company for the offence committed shall be prosecuted and punishable with rigorous imprisonment for a term not less than three months but which may extend to seven years with fine (Section 276B).
  - o In case of any default in tax payment by company, S.179 casts joint and several liability on directors of private company. However, in case of DDT liability of a private limited company, arguably, directors may defend applicability of s.179 of the Act on the ground that the liability under s.179 is limited to any tax due on income of the private limited company, whereas DDT is not a liability on income and is with respect to distributed profits, though regarded to be additional tax.

- **Refund Procedure**

  Consider a case where a domestic company declares dividend to its shareholders at its AGM or makes payment of interim dividend. Provisions of S.115-0(3) mandates the company and its Principal Officer to pay the requisite tax to the credit of the Central Government within fourteen days from date of declaration, distribution or payment whichever is earlier. Accordingly, the company makes requisite DDT payment, within due date.

  However, due to certain developments subsequent to the date of declaration of dividend, DDT liability may no longer subsist or tax paid by the company is found to be in excess of the requisite amount. Some of the illustrative situations which can result in such contingency could be as under:

  – Holding-company pays DDT in respect of dividend declared to its shareholders, but, at a later date in the same financial year receives dividend from the subsidiary in respect of which Holding Co. claims set-off in terms of s.115-O(1A).

– Merger of subsidiary with its parent as discussed at para 2.10 above.

– Excess DDT is paid due to sheer calculation or judgmental error

Difficulty to claim refund arises as there are no specific provisions in the statute on claiming refund. One may be able to contend that Section 237 makes it clear that any amount of tax recovered (DDT also being in the nature of additional tax) from the taxpayer that exceeds the amount which is properly chargeable under the Act is liable to be refunded. Further Gujarat HC in the case of *Torrent P Ltd. vs. CIT (35 taxmann.com 300)* ruled that if any person satisfies the Assessing Officer that the amount of tax paid by him or on his behalf or treated as paid by him or on his behalf for any assessment year exceeds the amount with which he is properly chargeable under the Act for that year, he shall be entitled to a refund of the excess amount. This was a case where the holding company merged with its shareholders post sanction of retrospective merger scheme by HC. Prior to sanction of merger scheme, the holding company had declared dividend to its shareholders in respect of which DDT was paid and accordingly a claim of refund was made. Additionally, Article 265 of the Indian Constitution will also support the refund claim which provides that one cannot impose tax in excess of the amount legally due from a tax-payer. Article 265 reads as below:

"Taxes not to be imposed save by authority of law. No tax shall be levied or collected except by authority of law"

Once it is admitted that DDT is paid in excess and is clearly beyond the liability triggered u/s. 115-O, one should be able to claim refund of such DDT or should be eligible to set off against future DDT outflows and hence the taxpayer may wish to explore the below options to the extent applicable to the fact pattern:

Option 1 : Revising return

Option 2 : Making claim during proceedings

Option 3 : Make out a separate application under S.237

Option 4 : Approach CBDT with a claim under s. 119(2)

Option 5 : Writ may be filed to High Court

Option 6 : Seeking adjustment of refund against other dues (S.245)

Concluding remarks

DDT provisions are relatively easy to administer and has less scope for tax evasion. However, the DDT scheme has been no less than a Pandora's box, which has invited unintended consequences especially for shareholders due to trigger of S.14A and also uncertainty on tax credit to non-resident shareholders in their home country. Currently, with the proactive approach of CBDT on issuing various clarifications on ambiguous and litigative matters, would be helpful for an immediate correction at Government's end to address the issues on S.115-O, if there is no proposal to switch back to classical system of dividend taxation.

The infinite library of the universe is in your mind.

— *Swami Vivekananda*

Priyanka Jain, *Advocate*

Shareholder's Taxability

Dividend received from an Indian company which has suffered dividend distribution tax ('DDT') under section 115-O of the Income-tax Act, 1961 ('the Act') is exempt from tax under section 10(34) of the Act. However, the benefit of this exemption granted to the shareholders on dividend received from an Indian company, for over a decade came under the scanner of the Finance Minister in the Finance Bill, 2016 presented on 29th February, 2016 whereby this blanket exemption was restricted by way of insertion of section 115BBDA and consequential amendment in the provisions of section 10(34) of the Act, with effect from 1st April, 2017.

New Provision of section 115BBDA and its implications

The new section 115BBDA was introduced to provide that any dividend income from a domestic company, exceeding ₹ 10 lakhs in the case of an individual, Hindu Undivided Family or a firm who is a resident in India shall be chargeable to tax at the rate of 10 per cent. It further provided that no deduction in respect of any expenditure or allowance or set off of loss shall be allowed while computing the dividend income. Accordingly, corresponding amendment was made under section 10(34) of the Act to provide that if tax is payable under the proposed section 115BBDA of the Act on dividend received, such dividend income would not be treated as exempt income.

Therefore, after the said amendment in addition to DDT, dividend exceeding ₹ 10 lakh received by individuals, HUFs and firms, who are resident in India, became taxable in their hands at the rate of 10 per cent. However, in the Finance Bill, 2017 the Finance Minister expanded the tax base of the assessees under said section from the aforementioned three categories of assessees to all resident assessees except the following would be subject to tax at the rate of 10 per cent on the dividend income received by them from a domestic company:

(i) a domestic company; or

(ii) a fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10; or

(iii) a trust or institution registered under section 12AA.

The Explanatory Memorandum to the Finance Bill, 2017 explains that the rationale behind this amendment was to achieve not just vertical equity amongst taxpayers but also to achieve horizontal equity among all categories of taxpayers deriving income from dividend. Hence, by virtue of this amendment, now the dividend income exceeding ₹ 10 lakhs of even association of persons ('AOPs'), body of individuals ('BOIs'), artificial juridical persons and local authorities would be subject to taxation. Further, even the promoter holdings held under a trust structure, and trusts created for the benefit of family members, which hitherto may not have fallen within the ambit of section 115BBDA, would now be covered under the ambit of this amendment.

It is noteworthy that this section which applies to only resident investors or shareholders who receive dividend from shares of domestic companies and not to dividend received from mutual funds, from foreign companies etc. However, it is pertinent to also note that by virtue of this amendment the same dividend income will get taxed both at the time of distribution of dividend (DDT paid by the domestic company) as well as on receipt of same above ₹ 10 lakh (in hands of shareholder), which clearly amounts to double taxation on same income and is inconsistent with the judicial view taken by the Apex Court in case of *C. R. Nagappa vs. CIT 73 ITR 626.*

The Hon'ble Supreme Court in the case of *Godrej & Boyce Manufacturing Company Ltd. vs. DCIT 394 ITR 449*, while affirming the decision of the Bombay High Court reported in 328 ITR 81, has held that section 14A disallowance has to be made also with respect to dividend on shares and units even on which tax is payable by the payer, under sections 115-O & 115-R of the Act. The Apex Court disregarded the proposition of the appellant assessee that *"the tax on such dividend is paid by the dividend paying company and not by the recipient of the dividends is of no consequence"*, and so held that provisions of section 14A introduced by the Finance Act of 2001 are clear and unambiguous so as to operate to disallow deduction of all expenditure incurred in earning the dividend income under section 115-O which is not includible in the total income of the assessee. The Apex Court emphasised that the literal meaning of Section 14A, is far from giving rise to any absurdity and appears to be wholly consistent with the scheme of the Act and the object/purpose of levy of tax on income and therefore, affirmed the well entrenched principle of interpretation that where the words of the statute are clear and unambiguous recourse cannot be had to principles of interpretation other than the literal view will apply. In this regard, the view expressed by this Court in *CIT vs. Calcutta Knitwears 362 ITR 673* was referred to: *"the language of a taxing statute should ordinarily be read and understood in the sense in which it is harmonious with the object of the statute to effectuate the legislative animation. A taxing statute should be strictly construed; common sense approach, equity, logic, ethics and morality have no role to play. Nothing is to be read in, nothing is to be implied; one can only look fairly at the language used and nothing more and nothing less."*

Therefore, in view of above, even if the application of provisions of section 115BBDA of the Act amounts to double taxation on same dividend income as explained above, Courts may apply the strict literal interpretation of provision to effectuate the legislative intent of reducing the vertical inequity amongst the tax payers.

Another, concern for shareholders is disallowance of expenditure made under provisions of section 14A of the Act. In the Explanatory Memorandum to the Finance Act 2001, by which Section 14A was inserted with effect from 1st April 1962, it was clarified that *"expenses incurred can be allowed only to the extent they are relatable to the earned income of taxable income"*. The object behind Section 14A was to provide that *"no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income Tax Act"*. Therefore, it is worthwhile to highlight the recent decisions of various Courts on disallowance of expenditure by application of provisions of section 14A of the Act:

(a) When shares are held as stock-in-trade

The Calcutta High Court in case of *CIT vs. G.K.K. Capital Markets (P) Limited 392 ITR 196* has held that where in case of assessee company, engaged in business of share trading, dividend income was treated as business income, no specific expenditure has been incurred to earn such dividend income and the shares held by assessee were treated as stock-in-trade, the Assessing Officer could not proceed to make disallowance under section 14A by applying rule 8D and therefore no disallowance with respect to exempt income can be made if the securities are held as stock-in-trade. The High Court in this case has distinguished its earlier decision in case of *Dhanuka & Sons vs. CIT 339 ITR 319* on facts and referred to decision of the High Court of Karnataka in the case of *CCI Ltd. vs. Jt. CIT 206 Taxman 563* in which the substantial question of law that arose was whether the provisions of section 14A of the Act are applicable to expenses incurred by the assessee in the course of its business merely because the assessee is also having dividend income when there was no material brought to show that the assessee had incurred expenditure for earning dividend income which is exempted from taxation.

In this regard, it is pertinent to draw reference to the Central Board of Direct Taxes ('CBDT') Circular No. 18, dated 2-11-2015, which carves out a distinction between stock-in-trade and investment and provides that if the motive behind purchase and sale of shares is to earn profit then the same would be treated as trading profit and if the object is to derive income by way of dividend then the profit would be said to have accrued from the investment. Therefore, when the securities are held by an assessee as stock-in-trade in its trading portfolio such that the assessee did not hold the securities to earn dividend or interest, but traded in them and the dividend or interest accruing thereon was only a by-product thereof or an incidental benefit arising therefrom it would not, therefore, be subject to the provisions of section 14A. This view has also been affirmed in case of *PCIT vs. State Bank of Patiala* by the High Court of Punjab & Haryana.

(b) When shares are bought for strategic purposes and no exempt income has been earned

The Delhi High Court in case of *Cheminvest Ltd. vs. CIT* reversing the Special Bench decision in its own case in 121 ITD 318 referred to its earlier decision in case of *CIT vs. Holcim India (P) Ltd. 57 taxmann.com 28* has held that section 14A also does not apply to shares bought for strategic purposes. In Cheminvest's case (supra) it was not disputed that the investment by the assessee in the shares of Max India Ltd. is in the form of a strategic investment and therefore, when the business of the assessee is of holding investments, the interest expenditure must be held to have been incurred for holding and maintaining such investment. It further held that no disallowance under section 14A can be made in a year in which no exempt income has been earned or received by the assessee. The interest expenditure incurred by the assessee which is in relation to such investments giving rise to *income* which '*does not form part of total income*', this expression in section 14A envisages that there should be an actual receipt of income, which is not includible in the total income and if in the relevant previous year no exempt income is earned by the assessee no disallowance under section 14A can be made.

Similar view has been upheld by Delhi Court in case of *PCIT vs. IL & FS Energy Development Company Ltd. 250 Taxman 174* wherein the Court declined to apply Board's Circular No. 5/2014 dated 11-2-2014 which clarified that section 14A would apply even when exempt income was not earned in a particular assessment year. Even in *Redington (India) Ltd. vs. Addl. CIT 392 ITR 633*, the Madras High Court quashed a similar contention of the Revenue. The Court there declined to apply the CBDT Circular by explaining that Section 14A is *"clearly relatable to the earning of the actual income and not notional income or anticipated income." Further, what is taxable under section 5 of the Act is the "total income"* which is neither notional nor speculative. Therefore, there has to be 'real income' which is exempt for disallowance under section 14A.

Even the subsequent amendment to section 14A does not particularly clarify whether the disallowance of the expenditure would apply even where no exempt income is earned in the assessment year in question from investments made, not in that assessment year, but earlier assessment years. However, the words *"in relation to income which does not form part of the total income under the Act for such previous year"* in the Rule 8D(1) indicates a correlation between the exempt income earned in the assessment year and the expenditure incurred to earn it. In other words, the expenditure as claimed by the assessee has to be in relation to the income earned in 'such previous year'. This implies that if there is no exempt income earned in the assessment year in question, the question of disallowance of the expenditure incurred to earn exempt income in terms of Section 14A read with Rule 8D would not arise. The same is also upheld by High Court of Madras in the recent decision of *CIT vs. Chettinad Logistics (P.) Ltd. 248 Taxman 55.*

The High Court of Bombay in its former unreported decision in case of *CIT vs. M/s. Delite Enterprises Income Tax Appeal No.110 of 2009* has held that no section 14A disallowance can be made if there is no tax-free income. Similar view was upheld by the High Court of Allahabad in case of *CIT vs. Shivam Motors (P.) Ltd. 230 Taxman 63.*

Another important issue is whether the disallowance under section 14A and Rule 8D is required to be adjusted while computing the book profits under section 115JB, the MAT provisions. Recently, the Delhi Bench of Tribunal constituted a Special Bench, considering differing views of various tribunals and the co-ordinate benches, to discuss the following two convoluted issues in case of *ACIT vs. Vireet Investment P. Ltd. 165 ITD 27*:

i. Disallowance under section 14A, would also adjust the profits computed under section 115JB; and

ii. Investments which did not yield exempt income, are to be considered in calculating disallowance under section 14A read with Rule 8D(iii).

The assessee in the Special Bench case *inter alia* placed reliance on the decision of the High Court of Delhi in case of *Maxopp Investment Ltd. vs. CIT 347 ITR 272,* wherein it was held that, no disallowance could be made under Sec.14A, where no expenditure had 'actually' been incurred in relation to exempt income. Further, it was also explained that the scope of section 14A and section 115JB of the Act are entirely different. Section 14A takes within its sweep both direct and indirect expenses having proximate connection with earning of exempt income. However, under clause (f) of Explanation 1 to section 115JB, only those expenses which are debited to profit and loss account and are relatable to earning of exempt income under section 10 are added back. Thus, only direct expenditure associated with the earning of said income would be added back. The assessee also relied on the decision of Delhi High Court in case of *Pr. CIT vs. Bhushan Steel Ltd.: ITA No.593/2015* which upheld the decision of the Tribunal in holding that disallowance under section 14A read with Rule 8D cannot be added while computing book profits as per section 115JB as Explanation to that section does not specifically mentions section 14A of the Act, the Review Petition filed by Revenue against the said decision has been dismissed by High Court *vide* order dated 3rd March, 2017.

However, in this regard it is also pertinent to note that in case of *CIT vs. JSW Energy Ltd. 239 Taxman 1,* the Apex Court has granted Special Leave Petition against High Court's ruling reported in 379 ITR 36, that where Assessing Officer while computing book profit under section 115JB had also added expenditure disallowed under section 14A and Tribunal sent matter back to Assessing Officer for reconsideration after working out deduction in terms of section 14A, read with Rule 8D, no appeal could be entertained against Tribunal's order.

Nonetheless, the High Court of Bombay in its recent decision of 5th January, 2018 in case of *CIT vs. Bengal Finance & Investments Pvt. Ltd.* dismissed the Department's appeal against the Tribunal's order wherein it has been held that amount disallowed under section 14A of the Act cannot be added to arrive at book profit for purposes of section 115JB of the Act. The Tribunal in this case had relied on the decision of Mumbai Bench of the Tribunal in the case of *M/s. Essar Tele-holdings Ltd. vs. DCIT in ITA No.3850/Mum/2010* in which it has been held that the amount disallowed under section 14A cannot be added to the amount of book profit under section 115JB. In this order it has been laid down that unless a particular expenditure is debited to the profit and loss account relating to the earning of exempt income, the same cannot be imported into the computation of book profit as clause (f) of Explanation 1 to section 115JB which only refers to the amount debited to the profit and loss account. In reaching this conclusion the Mumbai Bench relied on another order of the Delhi Bench in the case *Goetze (India) Ltd. vs. CIT [(2009) 32 SOT 101 (Del.)]* laying down similar proposition.

Implications of Section 94(7) – Dividend Stripping

Dividend stripping is a strategy to reduce the tax burden, by which an investor gets tax free dividend by investing or buying in securities (including units), shortly before the record date (date on which dividend is declared, called as cum-dividend) and selling or exiting after the record date (called as ex-dividend) at a lower price, thereby incurring a short-term capital loss. This short-term capital loss is compensated with the tax-free dividend. Further the shareholder/investor can set off such loss against capital gains – both short-term and long-term – as the law stands at present and can also carry forward the unabsorbed loss for set off in future years.

Applicability of provisions relating to Dividend Stripping:

i. Buying or acquiring any securities or units within a period of three months prior to the record date.

ii. Selling or transferring such securities within a period of three months after such date, or such units within a period of nine months after such date;

iii. the dividend or income on such securities or unit received or receivable by such person during the intervening period is exempt from tax.

All the above conditions should be fulfilled for applicability of section 94(7), if any of the conditions is not satisfied then this section will not be applicable. Further, the object of insertion of this section was a measure to curb creation of short-term losses by certain transactions in securities and units.

The shareholders/ investors must understand that the provisions of sub-section (7) to section 94 and section 14A of the Act, operate in different fields. The Apex Court has lucidly reconciled the difference between the two sections, in case of *CIT vs. Walfort Share and Stock Brokers P. Ltd. 326 ITR 1* has held that – *"Section 14A deals with disallowance of expenditure incurred in earning tax-free income against the profits of the accounting year under sections 30 to 37. On the other hand, section 94(7) refers to disallowance of the loss on the acquisition of an asset which situation is not there in cases falling under section 14A. Under section 94(7), the dividend goes to reduce the loss. It applies to cases where the loss is more than the dividend. Section 14A applies to cases where the assessee incurs expenditure to earn tax free income but where there is no acquisition of an asset. In cases falling under section 94(7), there is acquisition of an asset and existence of the loss which arises at a point of time subsequent to the purchase of units and receipt of exempt income. It occurs only when the sale takes place. Section 14A comes in when there is claim for deduction of an expenditure whereas section 94(7) comes in when there is claim for allowance for the business loss. One must keep in mind the conceptual difference between loss, expenditure, cost of acquisition, etc., while interpreting the scheme of the Act."*

Further, as also stated above, the Apex Court explained that the object of section 94(7) is to curb the short-term losses, it is to be applied for the assessment year(s) falling after 1-4-2002, and the loss to be ignored would be only to the extent of the dividend received and not the entire loss. In other words, losses over and above the amount of the dividend received would still be allowed from which it follows that the Parliament has not treated the dividend stripping transaction as sham or bogus.

Nonetheless, it should be borne in mind that section 94 covers holding of securities or units both as capital assets and as stock-in-trade and, hence section 94(7) would be applicable to both an investor as well as a trader of securities or units.


CA Rutvik Sanghvi & CA Kartik Badiani

Dividends – International Taxation Issues

1. Introduction

1.1 In recent times, more and more Indians have opened up to the idea of investing abroad. At the same time, foreign investors are increasingly investing by way of equity capital in India. This has led to inflow and outflow of investments to and from India. One common issue faced in such structures is regarding taxation of cross-border payments of dividends.

1.2 International taxation of dividends is a subject typified with complexities and issues. Apart from being a costly method of repatriation of profits (due to taxation at both the corporate and shareholder level), availing foreign tax credits on dividends is also fraught with challenges. For these and a few other reasons, corporates have resorted to transferring profits to their shareholders by way of interest wherever possible. The manner of substituting dividend payments with tax deductible interest payments is called 'Thin Capitalisation'. While Governments across the world have resorted to measures to fight Thin Capitalisation, India was one of the few countries which had till recently not enacted any substantial law against this tax avoidance.

From FY 2017-18, the Government has introduced provisions to restrict expenses by way of interest to related parties. While these provisions strictly do not counter thin capitalisation, its effect can be to disallow specified interest payments.

One of the fallouts of this provision can be that more and more corporates will resort to dividend payments instead of interest payments which could get disallowed as deductible expenditure. Therefore, a chapter on international tax provisions and issues relating to dividends is very timely and essential as part of this Journal's Special Story on Dividends.

1.3 It should be noted that separate chapters in this Journal explain and cover issues related to various types of dividends including those covered under clauses (a), (b), (c, (d) and (e) of Section 2(22) of the Income-tax Act. These dividends, whether earned by way of declaration, or on liquidation, etc., would equally have an impact on cross-border structures. For example, when a company in India provides loan to a company outside India in which the resident shareholder of the Indian company has 'substantial interest', such a shareholder will still be liable to tax in India as such loans are deemed to be dividends under the provisions of Section 2(22)(e). Therefore, care must be taken to analyse all types of dividends – whether paid or deemed to have been earned by the shareholder. Such payments may be classified as different incomes in the foreign country concerned, but it will still be taxable in India as 'dividends'.

1.4 The provisions and various issues in relation to the taxability of dividends from inbound and outbound investments have been discussed hereunder:

2. Taxability of Dividends on Inbound Investments[1]

The taxability of dividends distributed by an Indian Company in which investment is made by a non-resident, is discussed in the following paragraphs.

2.1 Tax implications in India

Section 115-O of the Income Tax Act, 1962 ('The Act') provides that any domestic company distributing any profits by the way of dividend shall be liable to pay a dividend distribution tax ('DDT') @ 15% (plus surcharge & cess). Accordingly, the Indian company should be liable to pay DDT @ 15% (20.358% in FY 2017-18 after grossing up provisions and including surcharge & cess).

On the other hand, the dividend income received by the non-resident investor is exempt under section 10(34) of the Act as distribution tax on such dividends has already been paid by the Indian company. Further, it is important to note that the additional dividend tax @ 10% under section 115BBDA, introduced from FY 2016-17, is not applicable to an assessee who is a non-resident. Consequently, there will be no withholding tax on payment of dividends by Indian company to its non-resident investor.

2.2 Foreign Tax Credit (FTC)

The dividends earned by the non-resident investors would be taxable also in the county where the investor resides. For example, an Australian investor earning dividends from shares he holds in an Indian company would be taxable in Australia also on such dividends. Such double taxation is generally resolved by Double Taxation Avoidance Agreements (DTAAs). Most of the Indian DTAAs contain provisions of 'Credit Method' for elimination of double taxation. As per the credit method, the withholding tax paid on dividends in India should be available as a credit against the tax payable on such dividends in the investor's country of residence.

However, as mentioned above, there is no withholding tax on dividends in India. Accordingly, question of credit of withholding tax paid in India does not arise. The question is whether DDT paid by the Indian company would be available as credit to the non-resident investor. To resolve this, one needs to check two things: Firstly, whether DDT paid in India is covered within the definition of 'income-tax' as per the respective DTAA; Secondly, whether Article on Elimination of Double Taxation (Article 23 of OECD and UN Models) contains the enabling language to facilitate claim of credit of DDT.

Further, even domestic laws of some countries contain provisions under which credit for DDT is also allowed. Mauritius has specifically clarified that the DDT paid by an Indian company should be allowed as an underlying tax credit to the Mauritian Resident[2]. Similar provisions are present in the domestic laws of Singapore and UK. The manner of providing the credit would differ, but in substance, credit for DDT is available. It must be noted that these countries have low or nil tax rates and hence the benefit may be restricted. Accordingly, in such cases eligibility to claim credit of DDT on dividend income paid by the Indian company comes from the domestic laws of the country in which the non-resident investor is a resident.

1 Disclaimer: The withholding tax rates and corporate tax rates and interpretation of local tax laws of the jurisdictions other than India have been provided in the article based on the information available in public domain and past experience of the Authors. It would be advisable to seek advice from a local tax consultant in the overseas jurisdictions before implementing any structure or making any transaction decision.

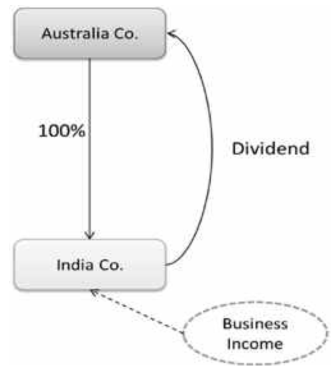
2 http://www.mra.mu/index.php/media-centre/rulings#TR99

2.3 Underlying Tax Credit

Further, in certain cases, where the provisions of the DTAA and the domestic law of the foreign country provide for Underlying Tax Credit (UTC) the recipient should be eligible for the credit of corporate taxes paid by the Company in India on profits out of which the dividends are paid. This credit of underlying taxes should be available in addition to the credit of tax paid on dividends. An example of how UTC works is provided in the illustration below:

Illustration I

- Australia Co. holds 100% of India Co.
- India Co. earns profits from business in India and distributes the same as dividends to Australia Co.



- A numerical example giving out the calculation of tax at each level and the net income at each level is given below:

Particulars	Amount
India Level	
Gross profit	1,000.00
Corporate Tax @ 34.608%[3]	346.08
NPAT	653.92
Less: DDT u/s 115-O @ 20.3583% (grossed up)	133.12
Net profit distributed as dividends to Australia Co.	520.80
Australia Level	
Dividend income	520.80
Grossing up Dividends (Corporate Tax in India)	346.08
Total Grossed up Dividends	866.88
Dividend Tax @ 30% (assumed)	260.06
Less: UTC to the extent of corporate tax paid in India as per Article 24 (Restricted to 260.06)	260.06
Net Dividend after Tax	866.88

As can be seen from the above illustration, the foreign company ends up getting the credit for the corporate tax paid by the Indian Company against the tax payable on the dividend income. The UTC is generally provided only where the investor meets the threshold of minimum investment in the Indian company. Therefore, this credit is not available to portfolio investors, but only to substantial investors. This threshold ranges from 10 to 25% depending on the treaty. This provision is present in a few countries with which India has a DTAA and some of them are listed below:

3 Assuming Surcharge @ 12% and Cess @3%

Country	% Holding Required	% Holding of –	UTC Benefit
Australia	10	Voting Power	UTC
China	10	Shares	UTC
Germany	10	Share Capital	Dividend Exemption
Japan	25	Voting Shares/Total Shares	UTC
Malaysia	10	Voting Shares	UTC
Mauritius	10	Shares	UTC
Singapore	25	Shares	UTC
Spain	25	Capital	UTC
UK	10	Voting Power	UTC
US	10	Voting Power	UTC

UTC is also available to Indian companies investing outside India, but in a very limited capacity. The same is explained in para 3.1.2 below.

2.4 Some issues

Some structures like liquidation of foreign companies having investments in India and buy-back of shares at a premium by Indian companies having non-resident shareholders involve complex issues on taxation of dividend. The same are discussed by way of following illustrations:

2.4.1 Liquidation of foreign companies hit by Indirect Transfer provisions

Following Supreme Court's verdict in Vodafone International Holdings BV[4], the Government introduced amendments in Section 9 of the Income-tax Act to cover transactions of overseas transfers where the value is derived from assets located in India. The amendment was brought about by way of Explanation 5 to Section 9(1)(i). This Explanation deems a specified asset to be situated in India if such a specified asset derives its value substantially from assets located in India, even if the specified asset may actually be located outside India. While this provision seeks to bring to tax in India capital gains on overseas transfers, it does so by way of deeming the specified asset to be **located** in India. Therefore, on a literal reading of the provision, it can also bring to tax any dividend income received from such shares (being specified asset) which are deemed to be located in India. When this unintended consequence was brought to the Government's attention, the CBDT has issued a clarification via Circular 4/2015 dated 26th March, 2015 where it is stated that the declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. Thus Explanation 5 of section 9(1)(i) shall not have any validity in such cases of taxability of dividends declared and distributed by foreign companies deriving value substantially from assets located in India.

However, does taxability arise in the hands of a shareholder of a Foreign Co. on its liquidation which results in distribution of dividend by the Foreign Co. u/s. 2(22)(c)? Let us look at the illustration below:

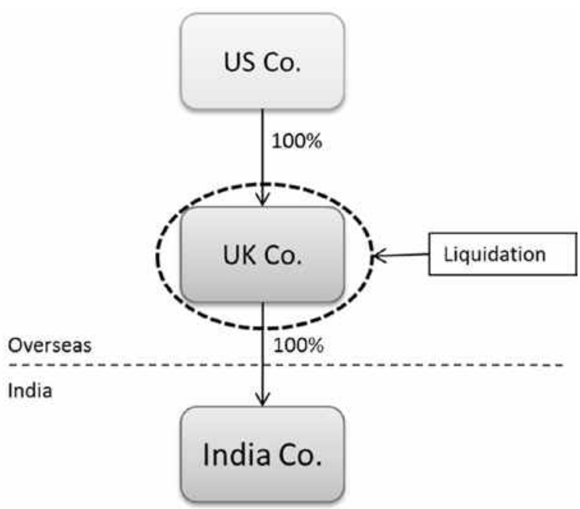
<u>Illustration II – Liquidation overseas</u>

Facts

- US Co. holds 100% investment in UK Co.
- UK Co. holds 100% investment in India Co.

4 Vodafone International Holdings B. V. vs. Union of India (341 ITR 1)

- UK Co. is to be liquidated
- UK Co. indirectly derived its value substantially from assets situated in India.



Issues

What should be the tax implications on such liquidation of UK Co.?

Comments and analysis

The distribution of assets on liquidation of UK Co. that indirectly derives its value substantially from assets located in India would attract provisions of section 2(22)(c) read with section 46 of the Act.

As per section 46(1) of the Act, when a company distributes its assets to its shareholders on liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45. Therefore, UK Co. should not be liable to pay any tax in India.

However, since UK Co. is substantially deriving its value from assets located in India, Explanation 5 of section 9(1)(i) should become applicable according to which shares of UK Co. shall be deemed to be situated in India.

As a result of this, section 46(2) of the Act shall come into effect, which states that when a shareholder on the liquidation of a company receives any money or other assets from the company, the amount to the extent to which the distribution is attributable to the accumulated profits of the company shall be considered as dividend income u/s. 2(22)(c) and the taxability under section 115-O (DDT) should apply accordingly. The remaining amount should be chargeable to income-tax under the head "Capital gains".

Therefore, receipt of assets on liquidation would be considered as dividend income and charged to tax accordingly in the hands of the shareholder, i.e., US Co.

However, if one literally follows the provisions of Explanation of section 9(1)(i) as discussed above, one may construe that as shares of UK Co. are deemed to be situated in India, if UK Co. declares any dividend, US investor company may be liable to pay tax on such dividend.

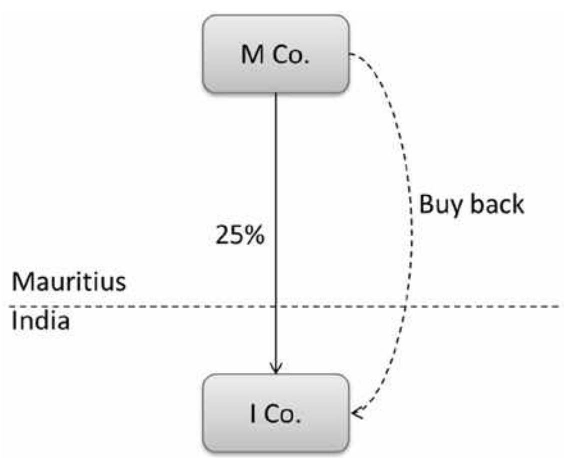
As mentioned above, CBDT has issued a circular stating the dividend declared by a Foreign Co. would not be taxable in case of indirect transfers. Therefore, dividends declared by UK Co. should not result in income accruing or arising in India and hence UK Co. should not be liable to pay any tax in India on dividends issued outside India. However, the Circular is applicable when dividend is "declared" and "paid" by a Foreign Co. Would it cover a situation similar to this illustration where dividend is taxable on account of a deeming provision under Section 46(2) and there is no actual declaration or payment of the same? In our view, the exemption from tax on dividend in such cases of overseas liquidation, should be available whether there is an actual payment of dividend or there is a deemed declaration of dividend as per section 2(22)(c). This is because the Memorandum to Finance Bill, 2012 (which introduced the provisions of 'indirect transfer') and circular 4/2015 referred above lay emphasis that the 'indirect transfer' provisions should apply only to a 'transfer' and should not apply in case of distribution of dividends. It further states that deeming provisions of 'indirect transfer' should be construed strictly. However, due to the precise wording used in the circular, a clarification would be desirable.

2.4.2 Buyback of Shares

Illustration III

Facts

- I Co. is an unlisted company incorporated in India. M Co., a tax resident of Mauritius holds 25% shares of I Co. which have been purchased by M Co. before 1-4-2017.
- I Co. had not distributed dividends since its incorporation and accumulated its profits.
- I Co. proposes a scheme of buyback of its shares in terms of section 68 of the Companies Act, 2013.
- M Co. intends to tender shares held by it under the buyback scheme.



Issues

What should be the tax implications of the buy back in the hands of M Co.?

Comments and analysis

Section 115QA of the Act provides that any company distributing any income by the way of buy-back of its own shares shall be liable to pay a Buy-Back Tax ('BBT'). BBT is levied at 20% (plus surcharge, if any and cess). Section 115QA is applicable only to those companies that do not have their shares listed on a recognised stock exchange. Therefore I Co. should be liable to pay BBT on buyback of shares proposed to be undertaken in the year 2017.

The dividend income received by the foreign investor should be exempt under section 10(34A) of the Act as tax on such dividends has already been paid by the Indian company in the form of BBT.

There is no clarity on availability of tax credit of the BBT against the tax payable on income on account transfer of shares under buy-back in overseas jurisdiction.

Implications prior to introduction of section 115QA

The buyback of shares by the Indian Company was considered as a transfer of shares by M Co. and accordingly income from such transfer of shares was chargeable to capital gains u/s. 46A of the Act in the hands of M Co.

However, as per Article 13 of India-Mauritius treaty, capital gain earned in India by a resident of Mauritius was taxable only in the country of residence of the transferor i.e. in Mauritius. Accordingly, M Co. was eligible to claim relief under Article 13 of the DTAA and the gains derived from transfer of shares should be taxable in Mauritius. Therefore, no tax would be payable by M. Co. on capital gains income from transfer of shares under buyback in India.

However, it is important to look at the AAR Ruling[5] in the case of OTIS Elevators wherein Capital Gains earned by a Mauritius Company from transfer of shares in India tendered under the Buyback was re-characterized as Dividend Income. While doing so, the AAR observed that, given the facts of the case, the buy-back arrangement was actually used a colourable device to avoid paying DDT in India on distribution of dividend.

5 Otis Elevators [AAR No. P of 2010]

Further, it is also important to note the clarification issued by CBDT via Circular 3/2016 which states that consideration received on buyback of shares between the period 1-4-2000 to 31-5-2013 would be taxed as capital gains in the hands of the recipient u/s. 46A and no such amount shall be treated as dividend. Further, with effect from 1-6-2013, section 115QA discussed above was introduced and therefore, question of re-characterisation does not arise.

As discussed above there were conflicting views and interpretations on the taxability of buyback of shares in the hands of shareholder prior to the issue of circular 3 / 2016, as many assessees who had tendered their shares under buyback were issued notices following the AAR ruling referred above. However, the taxability on buyback of shares is amply clarified with the introduction of Section 115QA and issue of Circular 3/2016 referred above.

Now, the provisions of General Anti Avoidance Rules ('GAAR') have come into effect. Does it mean that the entire issue of re-characterisation of capital gains to dividends needs to be re-evaluated altogether again?

In order to analyse the applicability of the GAAR provisions to any transaction, it is first important to check whether the act of the assessee (buyback of shares instead of declaring dividend) would fall within the definition of "arrangement" as per section 102(1) of the Act. The definition of "arrangement" as per section 102(1) includes any step in, a part or whole of any transaction, operation, scheme, agreement or understanding. In the instant case, buy-back of shares by I. Co. should qualify as a 'scheme' and therefore would fit within the definition of 'arrangement' as per section 102(1). However, if the company has already paid the BBT under section 115QA and the Act provides specific exemption to consideration received on buy-back of shares under section 10(34A), would there be a 'tax benefit' to invoke the GAAR provisions? Here, it is also important to note that Question 3 of Circular 7 dated 27.01.2017 clarifies that GAAR provisions will not interplay with the right of the tax payer to select or choose a method of implementing a transaction.

3. Taxability of Dividends on Outbound Investments

The taxability of an Indian resident receiving dividend income from a foreign company is interesting, especially after introduction of a lower rate of tax on such dividends received by companies in specific situations. Further, it is similarly as complex as dividends earned by non-residents from India, since one has to take into account the tax paid/deducted in the foreign country as well as the tax payable in India considering the provisions of the DTAA between the two countries.

It should be noted that dividend earned from overseas investments can be either from corporate entities like companies; or from Limited Partnerships, Limited Liability Corporations, etc., depending upon the laws in the foreign country.

The taxability of such dividends received from a foreign entity in the hands of an India resident is discussed in the following paragraphs.

3.1 Taxability in Overseas Jurisdiction and Credit in India of tax paid overseas

3.1.1 Taxability in Overseas Jurisdiction

As would be the case in India, most foreign countries would tax dividends declared by their resident entities. However, unlike India, most countries do not have a system of DDT which taxes the company declaring the dividends instead of the investor earning the dividends. Most countries levy tax on the income-earner, i.e., the shareholder or investor. The tax is collected generally in the form of withholding taxes. The withholding tax is levied as per the domestic tax rates of the local income-tax law. However, such tax would be restricted to the rate specified in the Article dealing with 'Dividends' of the relevant DTAA that country has with India.

Article 10(1) of the UN Model and OECD Model and the DTAAs signed by India with other jurisdictions confer the right to tax the dividend with the Country of Residence ('COR') of recipient. In other words, first right to tax dividend lies with Country in which the recipient of dividend is resident.

Article 10(2) provides a limited right to a Source Country ('COS') also to tax said dividend. However, the Source Country has to levy tax subject to certain ceiling (prescribed rate). In other words, Country of source taxes dividend at concessional rate. The benefit of concessional rate of tax is given subject to fulfilment of certain conditions provided under the relevant DTAA which include that the recipient should be:

a) resident of COR[6];

b) a beneficial owner of Dividend; and

c) holding at least prescribed per cent of the capital of the Company paying dividend.

If the above referred conditions of Article 10 are satisfied, the taxability of dividends in the overseas jurisdiction will be restricted to the ceiling rate specific under Article 10(2) of the DTAA.

It should be noted that tax in the foreign jurisdiction should be the same irrespective of the type of Indian entity earning the dividend – company, firm or individual.

3.1.2 Credit in India of tax paid overseas

3.1.2.1 Foreign Tax Credit

Most of the DTAAs entered into by India contain provisions of Foreign Tax Credit ('FTC') under the Article 'Elimination of double taxation'. As per the FTC mechanism, the withholding tax paid on dividends in foreign jurisdiction should be available as a credit against the tax payable on such dividends in India. In a case where India has not entered into a DTAA with an overseas jurisdiction, the FTC is available under section 91 of the Act. It is important to note that compliances specified under Rule 128 and filing for Form 67 is now mandatory to claim the FTC.

Apart from the tax levied in the country where the company is incorporated, an Indian investor should take note of certain provisions which are not present in India. One such provision is Franking of dividends. A franked dividend is an arrangement in Australia that eliminates the double taxation of dividends. The shareholder is able to reduce the tax paid on the dividend by an amount equal to the tax imputation credits. When a stock's shares are fully franked, the company pays tax on the entire dividend. Shareholders receive 100% of the tax paid on the dividend as franking credits. However, it can happen that the company issuing the dividend might not pay the entire tax rate on its profits in a particular year. When this happens, enough tax is not paid by the business for attaching a full tax credit to the dividends paid to shareholders. As a result, a tax credit is attached to only some portion of the dividend amount, making that portion "franked", and balance dividend amount as untaxed, or "unfranked". This results in a mixed tax impact on the Indian tax-payer as he still needs to declare the full income in India to tax, claim credit for taxes on the portion of income on which tax is deducted at source; and pay full taxes in India on which no tax has been deducted at source. Claiming credit for such taxes is all the more cumbersome as full details need to be now submitted online in Form 67 as per foreign tax credit rules in Rule 128. Participation exemption provisions are another set of provisions which are not present in India and can play an important role in structuring of investments.

3.1.2.2 Underlying Tax Credit

In addition to the foreign tax credit of the withholding taxes paid in the overseas jurisdiction, as discussed earlier, in some cases, UTC also should be available. UTC provides for credit of taxes paid on the corporate taxes from which dividends are

6 In some DTAAs, the benefit is higher in case of Corporate entities receiving dividends e.g. USA

distributed. However, India has not provided for UTC in its DTAAs with most countries except for a couple – Singapore and Mauritius.

Indian Companies which own more than 25% of the share capital of a Singapore Company paying the dividend should be eligible to claim credit of corporate taxes paid in Singapore out of which the dividend is paid from the tax payable on dividends in India as per Article 25 of the DTAA between India and Singapore.

Similarly, as regards investments in Mauritius, Indian Companies which own more than 10% of the share capital of a Mauritian Company paying the dividend should be eligible to claim credit of corporate taxes paid in Singapore out of which the dividend is paid from the tax payable on dividends in India as per Article 23 of the DTAA between India and Mauritius.

As can be seen from the above, UTC can lower the effective tax rate substantially. Further, a structure in which the Indian company invests through Singapore and Mauritius to countries with which either of these countries have similar UTC provisions can reduce the cascading effect of taxes substantially. Following illustration will explain the same:

3.2 Taxability in India

3.2.1 Taxability of Indian Companies:

With the introduction of Section 115BBD, taxability of foreign dividends has assumed a significant role for Indian companies investing outside India. The following paragraphs illustrate the taxation in the hands of Indian companies:

Prior to introduction of Section 115BBD by Finance Act 2011, the profits distributed by the Foreign Company to Indian Companies as dividends were subject to normal rate of tax applicable to companies as prescribed by the relevant Finance Acts (i.e., 30%).

Such high rates of tax on dividends from foreign companies proved to be a huge deterrent to the companies wishing to bring back their profits to India by the way of dividends. This resulted in piling up of cash reserves abroad. For quite a few years, Indian MNCs were lobbying for a lower tax rate on such foreign dividends. In view of the above, the Finance Act 2011 introduced Section 115BBD for providing a lower tax rate of 15% on dividends earned by Indian Companies from their foreign subsidiaries.

Accordingly, post the introduction of section 115BBD, an Indian Company receiving any income by the way of dividends declared, distributed or paid by a 'specified foreign company' should be liable to pay income-tax at the rate of 15% on such dividend income. As per Section 115BBD, 'specified foreign company' is defined as a Foreign Company in which the Indian Company holds 26% or more of the equity share capital.

To understand the effective tax rate in the hands of the Indian shareholders, one must also consider the provisions of Section 115-O. When such dividend earned by the Indian company from its foreign investee company is subsequently distributed by the Indian company to its shareholders, the company will be liable to pay DDT @ 15% (plus surcharge, if any and cess). However, the company will be eligible to claim a deduction of such foreign dividends from the dividends declared by it as per sub-section 1A of Section 115-O. This deduction is available only when the investment by the Indian company in the foreign company is more than 50%. Further, the dividends should be declared by the Indian company in the same financial year as the one in which it has received dividends from its foreign investee company. Consequently, the tax outflow on distribution of dividends by the Indian company should be nil and cash to the shareholders should always remain the same. This deduction provision was brought in to reduce the cascading effect of DDT on the eventual Indian shareholders. However, combining this deduction with the lower tax rate of 15% under Section 1115BBD, coupled with FTC and UTC to allay the foreign taxes, can result in the effective tax rate in the hands of the shareholder remaining at not more than 15%

even though the dividend income has travelled through the whole chain from declaration by foreign company to earning in the hands of the final Indian individual shareholders.

It should be noted that benefit of lower tax of 15% on dividend under section 115BBD is available only when dividends are received by an Indian Company and not any other entity. Further, the benefit is available only when the investment in the foreign company is above 26%. Also, deduction under Section 115-O(1A) of foreign dividends from dividends declared by the Indian company is available only to a company in which the Indian company holds more than 50% stake. This would have an impact on structuring of investments outside India which is explained in Illustration IV below.

With the introduction of Section 115BBD, there was a view that no problems will be faced in case of bringing in dividends from one's own subsidiaries outside India. This was because of the fact that the dividend income would anyways be offered to tax although subject to a lower 15% tax rate u/s 15BBD.

However, one must note that the Income Tax Officer can ask for the source of dividends declared by the foreign company where dividend amounts are not in sync with the investments made abroad, or with the level of business done by the foreign company.

Now that the PoEM and GAAR provisions have come into effect, such type of transactions could face greater scrutiny.

The entire gamut of taxability under section 115BBD and the availability of tax credit is explained in the following illustrations

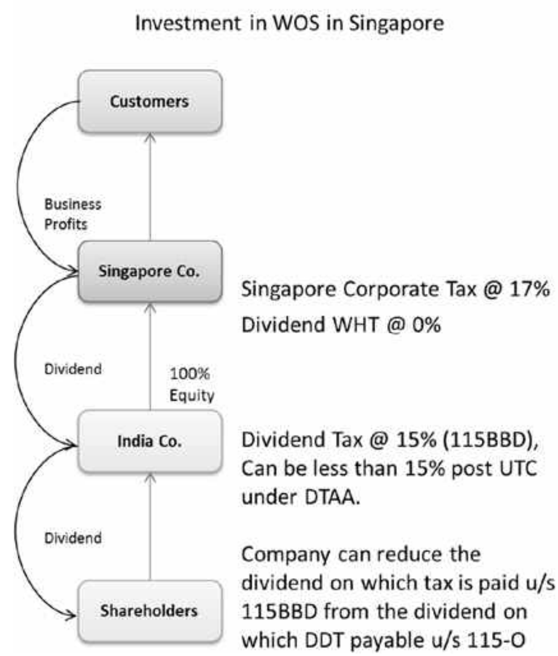
<u>Illustration IV – Outbound Investment by and Indian 'Company'</u>

Facts

- Singapore Co. is the wholly owned foreign subsidiary of India Co.
- Singapore Co. earns profits through its business in Singapore.
- Singapore Co. distributes its profits as dividend to India Co.
- India Co. distributes dividend received by it, net of taxes, to its shareholders within the same financial year.

Issue

What should be the tax implications on such distribution of Dividends?



Comments

- In the above case Singapore Co. should be liable to pay Corporate Tax @17% (under the tax laws in Singapore) on profits earned by it from its business. Singapore Co. should not be liable to pay any Dividend distribution tax/ Dividend Withholding tax in Singapore on distribution of dividends.
- India Co. should be liable to pay Tax @15% in India on receipt of dividend from its foreign subsidiary u/s. 115BBD. However, since I Co. holds 25% or more in Singapore Co., it should be eligible to claim credit of Corporate taxes paid in

Singapore under Article 25 of the India-Singapore DTAA under UTC provisions.

- Accordingly, tax liability under section 115BBD should be reduced by the eligible underlying tax credit as discussed above.
- Further, the dividend declared by the Indian company to its shareholders should attract no tax as the full amount of dividends earned from the Singapore company would be available as a deduction under Section 115-O.

In the above facts, what should be the tax implications in case the wholly owned subsidiary was established in UAE or UK instead of Singapore? ('WOS')

The detailed comparison of tax implications at each level in case of a WOS in Singapore, UAE and UK are given as under.

Particulars	Singapore (Amount)	Dubai (Amount)	UK (Amount)
Gross profit	1,000.00	1,000.00	1,000.00
Corporate Tax paid overseas @17% (Singapore) & 19% (UK)	170.00	-	190.00
NPAT	830.00	1,000.00	810.00
Less: Dividend WHT (Nil in all jurisdictions)	-	-	-
Net profit available to Indian Co.	830.00	1,000.00	810.00
<u>India Level</u>			
Dividend income	830.00	1,000.00	810.00
Add: Corporate Tax in paid in Singapore	170.00	-	
Dividend (Grossed up for Singapore)	1,000.00	1,000.00	810.00
Less: Tax u/s 115BBD @ 17.304%[7]	173.04	173.04	140.16
Add: UTC to the extent of corporate tax paid overseas	170.00		
Net Dividend Income (Dividend Income – Tax + UTC)	826.96	826.96	669.84
Less: DDT u/s 115-O post reduction of foreign dividend	-	-	-
Net Dividend to shareholders	826.96	826.96	669.84

It should be noted that dividend in the hands of shareholders covered under Section 115BBDA may further be liable to a 10% tax if the dividend amount crosses ₹ 10 lakhs in the financial year concerned. This would impact final tax amount payable in the hands of such shareholders. As can be seen from above, the differences in the tax rates of different countries and the provisions of the DTAA regarding underlying tax credits have a significant effect on the final net dividend received by the shareholders in India. It can be seen that in case of UAE, the entire tax is paid in India while in Singapore and UK only a part of tax is paid in India and the rest is paid in the source country from which the dividends are received. Accordingly, while setting up an overseas structure for business abroad, all the aspects discussed above needs to be kept in mind.

3.2.2 Taxability of Indian 'Individual / Firm / LLP'

When an Individual earns income in the form of dividends from a foreign company, the said dividends should not be considered as exempt income u/s. 10(34). This is because the provisions of section 115-O are applicable only to a domestic (Indian) company and does not apply to a Foreign Company. Consequently, dividends paid by such foreign company should be taxable in India. The individual should be liable to pay tax on the dividend income as per the slab rates as prescribed under the relevant Finance Act.

7 Assuming Surcharge @ 12% and Cess @3%

Similarly, when a firm or an LLP earns income in the form of dividend from a foreign company, the LLP or the firm should be liable to pay tax on such income at normal rates applicable to them, i.e., 30% (plus surcharge, if applicable and cess).

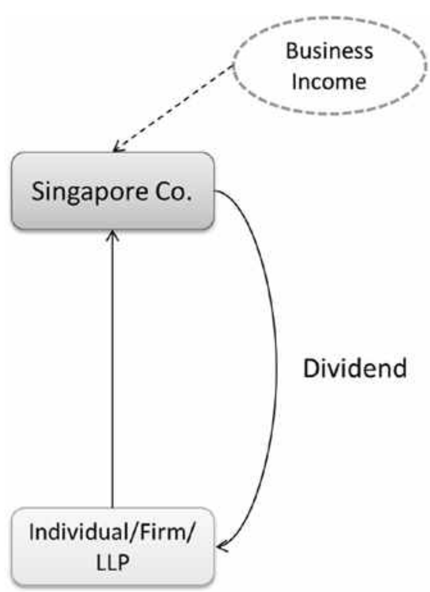
In either of the above cases i.e. Individual/Firm/LLP, the recipient should be eligible to claim credit of taxes withheld or paid (Foreign Tax Credit) by the Foreign Company in the source country in relation to the dividends distributed as per the provisions of the Double Tax Avoidance Agreement ('DTAA') between the two countries as explained in para 3.1.2 above.

The above is explained further by the way of following illustration:

Illustration V – Outbound Investment by India 'Individual/Firm/LLP'

Facts

- Individual/firm/LLP has made investments in a Singapore Co. in Singapore.
- Singapore Co. distributes dividend to Individual/firm/LLP.
- Individual has other income in India due to which his dividend income would be liable to 30% tax.



Issue

What should be the tax implications on such distribution of Dividends?

Comments and analysis

- As per Singapore Tax Laws, the Singapore Co. should be liable to pay Corporate tax @ 17% on business profits earned in Singapore.
- The Singapore Co. should not be liable to withhold tax on profits distributed as dividends to Individual/Firm/LLP resident in India.
- When the recipient of dividend is an Individual, the tax on such dividend should be payable as per the slab rates applicable to such Individual.
- Similarly, when the recipient of dividend is a Firm/LLP, tax @ 30% (plus surcharge, if any and cess) should be payable.
- If the Partnership Firm or LLP further distribute the amount to individual promoters/partners, they should not be liable to pay any tax as benefit u/s 10(2A) of the act shall be available.
- A numerical example giving out the calculation of tax at each levels and the net income at each levels is given below:

Particulars	Amount
Singapore Level	
Gross profit	1,000.00
Corporate Tax @ 17%	170.00
NPAT	830.00
Less: Dividend WHT	-
Net profit available to Indian Co.	830.00
India Level – Partnership Firms/ LLP	
Dividend income	830.00
Less: Tax [830 x 34.608%[8]]	287.25
Cash in the hands of Firm/LLP	542.75
Tax on Profit Distribution	-
Cash in the hands of promoters/ partners	542.75

8 In case of an Individual who has already exhausted his threshold limits, the applicable rate will be 35.535%.

As can be seen from the above table, the total tax outflow of Singapore Co. is ₹ 170/- on a profit of ₹ 1,000/-. The Singapore Co. distributes entire after-tax profits of ₹ 830 as dividends.

In India, the Firm /LLP who are the recipients of dividends pay a tax of ₹ 287.25. Here, it is important to note that as per India – Singapore DTAA, UTC is available on to an Indian company receiving dividends from abroad. UTC is not available to Indian Individual, Firm or an LLP. Further distribution by Firms/LLP is exempt. Thus, the net cash in the hands of the promoters/partners is ₹ 542.75/-

As can be seen from the above illustrations, tax liability in the hands of entities other than companies can be higher due to the lower tax rate under Section 115BBD and due to non-availability of UTC. Now more and more investments are happening outside India by Individuals and LLPs. It would be prudent for the Government to make a level playing field by providing the lower tax rate benefit for all investing entities and not restrict the benefit to just companies.

4. Structuring of Inbound and Outbound Investments

As can be seen from the above discussion, taxability of Dividends is a key aspect in structuring of inbound and outbound investments. Accordingly, taxability of dividends at each level in the structure needs to be minutely examined.

Lately, with the introduction of anti-avoidance provisions like GAAR and Place of Effective Management under the Act and the 'Principle Purpose Test Rule' under the recently concluded signing of Multilateral Instruments, it has become very important to look into and comply with the 'substance over form' doctrine while structuring of inbound and outbound investments.

Apart from the above, it is also important to take a note of jurisdiction specific provisions such as Participation Exemption which is most prevalent in the European Union and is a classic tool used for structuring of investments into European Union. It is also important to examine the implications under other applicable laws like the Foreign Exchange Management Act, 1999, and the provisions of Companies Act 2013 especially with reference to permissibility of multi-layered structures, underlying subsidiaries, etc.

5. Conclusion

One needs to consider a myriad of provisions while determining the taxability of cross-border payment of dividends. Tax provisions of respective countries should also to be taken into account while determining not just the taxability of cross-border dividends, but also while structuring the investment at the first stage.

Additionally, what needs to be kept in mind is the changing laws of different countries. The recent US tax reforms is a classic example which contains major amendments proposed in respect of dividend taxation. With US taking the lead, more countries can be expected to come up with favourable tax provision in respect of repatriation of dividends from overseas jurisdictions. We need to wait and watch if such reforms are replicated in other countries as well. We are in interesting times now as regards structuring of cross border investments.

Desire, ignorance, and inequality – this is the trinity of bondage.

— *Swami Vivekananda*

CA Umesh K. Gala

Tax on Buy-back u/s. 115QA of the Income-tax Act, 1961

1. Background

1.1 The provisions relating to taxation on buy back of shares are included as part of Chapter XII-DA titled 'Special Provisions relating to tax on distributed income of domestic Company for buy-back of shares'. This chapter covers sections 115QA to 115QC of the Income-tax Act, 1961 ("the Act") which have been introduced by the Finance Act, 2013 with effect from 1-6-2013. Consequent thereto a new section 10(34A) has been introduced with effect from 1-4-2014 which provides exemption for any income arising in the hands of the shareholders on account of buy back of shares covered u/s. 115QA.

1.2 Prior to introduction of Chapter XII-DA, the tax treatment in respect of such buy-back was governed by S. 46A (introduced by the Finance Act, 1999 with effect from 1-4-2000) under which capital gains was payable on the amount received by the shareholders on account of any buy-back of shares. A corresponding provision was also introduced in S. 2(22)(e) to provide that dividend will not include any amount paid on account of purchase of its own shares by a company. Even though the said exclusion still refers to S. 77A of the erstwhile Companies Act, 1956, it can be construed to include provisions of any law relating to companies as was inserted in the definition of the term buy-back u/s. 115QA by Finance Act, 2016 (discussed later).

1.3 As per S. 115QA to S. 115QC of the Act, any amount of distributed income by the company on buy-back of shares (not being shares listed on a recognized stock exchange) from a shareholder shall be charged to tax and such company shall be liable to pay additional income tax at the rate of twenty per cent plus surcharge (12%, at present) and education cess (3%, at present) aggregating to 23.072% on the distributed income.

1.4 Buy-back of shares was permissible under the provisions of Companies Act, 1956 and has now been continued under the provisions of S. 68 of the Companies Act, 2013 as well. The relevant rules for buy-back of shares are laid down in Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014.

2. Rationale behind introducing Chapter XII-DA

2.1 Under the Act, every company distributing dividend to its shareholders is liable to pay by way of additional tax, a Dividend Distribution Tax (DDT) @15% u/s. 115-O of the Act subject to grossing up and surcharge and education cess, aggregating to 20.36%. However, taking advantage of DTAA, many times the payment of DDT on distribution of dividends was avoided by resorting to buy-back of shares. This was done whereunder the double tax avoidance agreement (DTAA) signed by India with a few countries, where the right to tax was ceded in favour of the country of residence i.e., not liable to tax in the source State of India under the provisions of DTAA and the capital gains were entire not taxable in the country of residence or taxable at lower rates. For example, DTAA with Mauritius, Cyprus, Singapore, etc. In many non DTAA situations, buy-back was advantageous where the capital gains in the hands of shareholders were either not taxable on account of capital losses or due to indexation or due to roll over exemptions like S. 54EC, 54F etc. As a result, neither company nor the shareholders paid any tax and consequently, entire transaction of buy-back used to escape the tax net.

2.2 The rationale for introducing Chapter XII-DA has been explained by the explanatory Memorandum to Finance Act, 2013, the relevant portion of which reads as under:

"Unlisted Companies, as part of tax avoidance scheme, are resorting to buy-back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at lower rate. In order to curb such practice, it is proposed to amend the Act…"

Thus, it can be said that Chapter XII-DA was introduced as an anti-avoidance measure.

3. Scope of S. 115QA to S. 115QC:

3.1 S. 115QA is applicable to domestic companies on buy-back of shares (not being shares listed on a recognized stock exchange) from a shareholder.

3.2 The company carrying out the buy-back of shares is liable to pay additional tax on the 'distributed income' and the rate of tax is 20% plus applicable surcharge and cess, hereinafter referred to as 'the buy-back tax'.

3.3 Buy-back has been defined to mean purchase by a company of its own shares (in accordance with the provisions of S. 77A of the Companies Act up to 1-6-2016) and thereafter under any provisions of any law for the time being in force relating to companies [Explanation (i) to S. 115QA(1)].

3.4 The term distributed income means the consideration paid by the company on buy-back of shares as reduced by the amount received by the company for issue of such shares. The amount received by the company is to be determined in such manner as may be prescribed. Rule 40BB has been introduced to lay down such determination in different situations (discussed later).

3.5 Such buy-back tax is payable even where no income tax is payable by the company [S. 115QA(2)].

3.6 Tax on buy-back must be paid within fourteen days from date of payment of any consideration to shareholders on buy-back of shares referred to in S. 115QA(1) [S. 115QA(3)].

3.7 The buy-back tax is treated as final payment of tax on the said income and no credit in respect of the buy-back tax paid can be availed by the company or by any other person [S. 115QA(4)].

3.8 Further, no deduction shall be allowed to the company or a shareholder in respect of income which has been charged to tax u/s. 115QA or the tax paid thereon [S. 115QA(5)].

3.9 Correspondingly, any income arising on account of buy-back of shares covered by S. 115QA is exempt in the hands of the shareholders u/s. 10(34A) of the Act.

4. Amendments brought in by the Finance Act, 2016

4.1 S. 115QA as introduced by the Finance Act, 2013 defined buy-back as under:

"buy-back" means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956.

4.2 The said definition created some ambiguity since buy-back under other provisions of the Companies Act, 1956 was not covered. In particular, buy-back under a scheme of compromise or arrangement with the shareholders under S. 391 to S. 394 were not specifically covered. Also, the Companies Act, 1956 has been replaced by Companies Act, 2013 making reference to S. 77A redundant.

4.3 In view of the above, Finance Act, 2016 amended the definition of buy-back with effect from 1-6-2016 to include purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies.

4.4 S. 115QA as introduced by the Finance Act, 2013 defined distributed income as under:

"distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares. The determination of amount received on account of shares may create some difficulty in different situations like amalgamation or merger, demerger, issue of shares in consideration other than cash, ESOP, etc. Accordingly, concerns were raised about lack of clarity in such situations.

4.5 In view of the same, Finance Act, 2016 with effect from 1st June, 2016 amended the definition of distributed income to provide that the amount received by the company for issue of such shares shall be **determined in the manner as may be prescribed**. Accordingly, R. 40BB has been introduced in the Income Tax Rules, 1962 (Rules) for determining the amount received by the company in respect of buy back of shares.

5. R. 40BB for determining amount received by the company

R.40BB has been introduced *vide* CBDT Notification No. 94/2016 dated 17th October, 2016 with retrospective effect from 1st June, 2016. R. 40BB provides a mechanism for computation of amount received by the Company in different situations as covered under different sub rules of Rule 40BB. A detailed analysis of rule 40BB is as under:

5.1 Sub-rule (2): Subscription

When shares are issued by way of subscription, amount received by the company shall be the amount *actually received* by the company, including share premium received

- This rule covers shares issued for consideration by direct subscription by cheque or cash. The amount received will include the amount received towards face value as also the share premium. The term 'subscription' used here should not be limited to issue of shares by way of subscription to Memorandum of Association of the company but also allotment of shares by the company to persons who have subscribed to such shares on an offer being made by the company or under rights issue. Further, it also includes private placement of shares u/s. 42 of the Companies Act, 2013. However, any secondary sale of shares from one person to another will not be covered here.
- Quite often the Company may issue shares against the amount outstanding in the loan or similar payable account of the allottee. Such cases may not be covered under sub-rule (2) but under sub-rule (8) (discussed later)
- Paid-up capital which is lost or is unrepresented by available assets may be reduced under a capital reduction scheme. In such cases the face value of the shares may be reduced from ₹ 10 to say ₹ 2/- per share without issue of any consideration to the shareholders. In such cases also, irrespective of the revised face value of the shares the amount originally received on issue of shares will be considered as received under this sub-rule.

5.2 Sub-rule (3): Capital returned to shareholders

If the company repays a part of the capital received under a scheme of capital reduction, the amount received by the company shall be *the amount received for issue of shares less amount so returned.* However, if the amount so returned was subject to DDT u/s. 22(2)(d) to the extent of accumulated profits and the company has paid DDT then such sum shall not be reduced for determining the amount received by the company.

- However, this exclusion is limited to cases where DDT has been paid. Any amounts which were taxed as dividends in the hands of the shareholders u/s. 2(22)(d) before introduction of the DDT should also be excluded since they have already suffered tax in the hands of shareholders. The sub-rule requires to be amended to clarify this.

5.3 Sub-rule (4): ESOP or sweat equity

When shares are issued under any Employee Stock Option plan or scheme or as part of sweat equity shares, the amount received by the company shall be Fair Market Value (FMV) of shares considered for taxation of perquisite under Rule 3(8), *to the extent credited to the share capital and share premium account.*

- Under the existing provisions of S. 17(2)(vi) the perquisite on account of issues of shares under an ESOP or sweat equity is taxable at the time when shares are exercised/allotted. The perquisite is computed under Rule 3(8) by considering the FMV of the shares at the time of exercise or issue. However, the catch here is that the FMV only to the extent credited to the share premium shall be included. Let us consider an example. Shares of face value of ₹ 10 having FMV on date of grant of ₹ 100 are granted at ₹ 80. The Company would account for ₹ 20 being intrinsic or based on fair value of option, discount as part of employee compensation. The FMV at time of exercise on which the perquisite tax is paid by the employee is ₹ 400. Under the present accounting standards / guidance note the sum amount received at time of exercise plus the ₹ 20 which is credited to employee compensation account will be credited to the share capital and share premium account. The difference of ₹ 300 out of ₹ 320 on which the employee has paid the perquisite tax will suffer buy-back tax u/s. 115QA as credit will be denied under this sub-rule since the entire value on which perquisite tax is paid is not credited to share capital or share premium. To this extent the sub rule appears to be unequitable and needs to be amended.

5.4 Sub-rule (5): Amalgamation

When shares are issued by an amalgamated company (say 'A'), under a scheme of amalgamation, in lieu of shares of an amalgamating company (say 'B'), then amount received by the amalgamating company B, *in respect of the original shares, __**determined as per this rule**__ shall be considered*.

- In a case where B had issued shares on account of an earlier amalgamation or demerger or other situation etc. of company C, then the amount received by C determined under this rule shall be considered as received by the company.
- The terms like demerger, amalgamation, etc. used in R. 40BB have not been defined under the Rules. Whether these terms take colour from the terms as defined in the Act can be an issue. It is felt that in cases where the amalgamation or demerger complies with the definitions given in the Act, the relevant sub-rule would apply. However, where the amalgamation or demerger does not qualify as 'amalgamation' or 'demerger' under the Act i.e., in the case of a non-tax

neutral amalgamation or demerger, it is felt that the same would still be covered under the relevant sub-rule. The objective of Rule 40BB is to determine the amount received on the shares under different situations. Once shares are issued under an amalgamation scheme as commonly understood, then the same should be covered under this sub-rule.

5.5 Sub-rule (6) and sub rule (7): Demerger

In respect of shares issued by the resulting company under a scheme of demerger, the amount received by the resulting company shall be equal to:

Amount received by demerged company (determined under this rule)	*X*	*Net book value of assets transferred* / *Net worth of demerged company*

In respect of buy-back of original shares of demerged company, the amount received by the demerged company shall be equal to:

Amount received by demerged company – Amount calculated as per sub-rule (6)

- Sub-rules (6) and (7) relate to demerger of a company and cover determination of amount received *qua* a resulting company and the demerged company respectively.
- The amount received by the demerged company has to be determined in accordance with this Rule. Hence, depending upon situation under which the shares were issued, the relevant sub-rule may be applied.
- The term used is 'net book value of assets'. It is felt that since the determination is as a proportion of the net worth the term net book value of assets would refer to net assets after excluding the liabilities. One may incidentally point out here that for the purpose of allocation of general or multipurpose borrowings between the demerged company and resulting company under Explanation 2 of S. 2(19AA) as also the allocation of non-specific losses or unabsorbed depreciation of the demerged company u/s. 72A(4), the proportion that is required to be applied is *qua* the gross assets and not net assets.
- Though not clarified, any revaluation of assets ought to be excluded.
- The term 'net worth' has not been defined under R. 40BB. As per Explanation to S. 49(2E) of the Act, 'net worth' means aggregate of paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger. It is felt that 'net worth' as understood under accepted accounting parlance should be considered. Though there can be two views on this, any capital reserve created on account of any merger or demerger which is not as a result of fair valuation of assets ought to be considered as part of net worth. Share premium also ought to be included in computing net worth.

5.6 Sub-rule (8): Consideration in kind

When the share has been issued or allotted by the company as part of consideration for acquisition of any asset or settlement of any liability, the amount received for issue of shares is the specified proportion of the FMV of the asset or liability, as determined by a merchant banker. The specified proportion is part of consideration paid for issue of shares to total consideration. This proportionate FMV cannot exceed the amount credited to share capital and share premium by the company.

This is mathematically described in the sub-rule as under:

Amount received = A/B

Where,

A = an amount being lower (a) and (b) where-

$$(a) = \text{FMV of asset or liability} \times \frac{\text{Consideration paid in form of issue of shares}}{\text{Total consideration paid}}$$

(b) amount of consideration paid in the form of shares, to the extent credited to the share capital and share premium account;

B = the number of shares issued by the company as part of consideration

- This sub-rule seeks to apply a mathematical formula to the FMV of the asset or the liability. The FMV has to be worked out by a merchant banker as defined in Rule 3(8)(iv)(b) – for ESOP valuation. A category I merchant banker is so defined in the said Rule.
- Once the FMV is determined, a proportion is to be applied. The specified proportion is consideration paid for issue of shares to the total consideration. To work out the proportion, quite obviously both of these need to be in monetary terms. Hence, unless the part of the consideration which is discharged by issue of shares is ascertainable in monetary terms the formula cannot be applied.
- Take situations – Situation A in which consideration of issue of an asset or settlement of a liability is ₹ 100 of which ₹ 70 is paid by cash and balance by issue of shares. Then if the FMV of the asset is 80, then the formula will be ₹ 80 (FMV of the asset) *30 (consideration paid in the form of shares) /100 (total consideration paid) = 24
- However, situation B, the company acquired land against payment of ₹ 50 lakhs in cash and issue of 1 lakh shares. In this case, consideration paid in form of shares (1 lakh shares) is not readily ascertainable in monetary terms and hence, the formula may be difficult to apply. The formula could also potentially fail in such cases. Hence while working out the lower of (a) or (b) as given in the sub-rule, one may ignore (a) and limit the amount received to (b) i.e., what is recorded in books as share capital and share premium.
- This rule seeks to cover cases where the consideration for acquisition of an asset or settlement of a liability is partly in kind and partly in cash. A question for consideration is where only shares are issued for acquisition of an asset or settlement of a liability and nothing paid in cash, whether the proportion is to be considered as 1 (as both numerator and denominator would be same). Hence the FMV of the asset will be the amount received for shares. This will need to be further restricted to amount recorded in books under part (b) of the above formula.
- The sub-rule requires the value of an asset/liability to be determined by a merchant banker. Whether a merchant banker would be an appropriate person to determine the value of different categories of assets like immovable properties, complex intangible assets, jewellery etc. is open for consideration. Normally a merchant banker would be an appropriate person for determining the valuation of shares but not of various baskets of assets. That is field of specialized experts of the given asset class.
- The sub-rule also does not specify the date on which such valuation by the merchant banker has to be done. Is it the date of acquisition of the asset/settlement of a liability or date of issue of shares. There may be a time gap between the acquisition of asset or settlement of liability and issue of shares for such asset or liability. In such a case, the sub-rule does not provide clarity as to whether FMV as on date of acquisition of asset or settlement of

liability must be taken. A better view is that FMV should be determined on the date of asset acquisition or liability settlement.

- This sub-rule may be difficult to apply where in consideration of an asset acquisition, different classes of shares are issued i.e., equity shares and preference shares or voting equity shares and non-voting shares.
- Under part (b) in the formula above, the amount actually credited to share capital or share premium is to be considered. Under Ind AS 103, if the business combination under which shares are issued is with entities under common control, then the assets etc., of the acquired entity are required to be recorded at book value and consequently the amount recorded towards share capital and share premium will also be lower, to that extent.
- In many cases the company may acquire assets or business for fixed monetary consideration and the consideration so payable to the sellers is discharged by issue of shares equivalent to the consideration payable. Under the erstwhile provisions of S. 227(1A)(f) of the Companies Act, 1956 [S. 143(1)(f) of the Companies Act, 2013] the auditors where required to state whether, where the company claims that shares have been issued for cash whether the company has actually received the cash. In paras 8.5 and 8.6 of the Statement of Auditing Practices issued by ICAI it was stated that where the shares are issued against a debt payable in money then it ought to be regarded as issued for cash following the principle laid in Spargo's case. It might be possible to take a view that issue of shares against a liability immediately payable may be regarded as monetary consideration covered under sub-rule (2) rather than this sub-rule. Also, the FMV of a liability payable in monetary terms will be same giving rise to same result.
- The FMV of a liability payable after a period of time may be considered to be its present value. Similarly, where the liability is not specified in monetary terms, the FMV may not be its accounted value.
- Shares can be issued partly in cash and partly in kind. For determination of consideration in kind, sub-rule (8) can be applied and for cash consideration sub-rule (2) can be applied. However, the Rule 40BB is silent on the calculation of amount received by the company where more than one sub-rule applies. Such situations may alternatively get covered under residuary sub-rule (13). Better view is to determine total consideration using more than one sub-rule as applicable. A clarification is necessary in this regard.

5.7 Sub-rule (9): Conversion of a firm/ proprietary concern

When shares are issued or allotted by a company on succession or conversion of a firm into the company or succession of sole proprietary concern by the company,

Amount Received = (A - B) / C

A = (book value of the assets in the balance-sheet) - (TDS + TCS + Advance Tax - Refund claimed under the Act) – (amount shown in the balance-sheet as asset including the unamortized amount of deferred expenditure which does not represent the value of any asset);

Further, while determining book value of assets, any change in value of asset as a result of revaluation is to be ignored

B = book value of liabilities shown in the balance-sheet, but does not include the following amounts, namely:

(a) Capital, by whatever name called, of the proprietor or partners of the firm, as the case may be;

(b) Reserves and surpluses, by whatever name called, including balance in profit and loss account;

(c) Provision for taxation - (TDS + TCS + Advance Tax - Refund claimed under the Act);

(d) Provisions made for meeting unascertained liabilities;

(e) Contingent liabilities,

C = number of shares issued on conversion or succession.

- This sub-rule provides a formula for calculating the amount received per share on succession or conversion of partnership firm or succession of a proprietary concern into a company. In case of assets, any revaluation in value of assets is to be ignored so as to ensure that amount received by the company is not artificially increased by resorting to revaluation. Further, the sub-rule clearly defines liabilities such that any capital/reserves/excess provision for tax/unascertained liability/any contingent liability is not considered for calculating amount of liability.
- This sub-rule would apply where a firm is converted into a company under Chapter XXI (corresponding to part IX of Companies Act, 1956).
- However, in case the business of a firm is acquired/succeeded by company under the provisions of S. 47(xiii) then this sub-rule may not apply especially where the business is acquired for a fixed monetary consideration and the consideration is discharged by issue of shares. Sub-rule (8) may be a better rule to apply. This may be further supported by fact that in such case the firm may still continue to exist as only the business has been succeeded and not the firm. Hence, there may be no succession or conversion of the firm.
- The sub-rule covers conversion or succession of a firm whereas in case of a proprietary firm only succession is covered. Whether a succession of the business of a proprietary firm under S. 47(xiv) is equivalent to succession of the proprietary firm can be debatable. Difficulty may arise where such proprietary firm is acquired at fair value. The sub-rule if applied will consider only book value of assets and liabilities.

5.8 Sub-rule (10): Bonus shares

When shares are issued or allotted, without any consideration, amount received by the company shall be Nil.

- This sub-rule covers the issue of bonus shares by the company. Under S. 63 of the Companies Act, 2013 only fully paid bonus shares can be issued.

5.9 Sub-rule (11): Conversion of preference shares/debentures

When shares are issued on conversion of preference shares or bond or debenture etc., the amount received by the company shall be the amount received in respect of such instrument.

- It may be noted that unlike other sub-rules, there is no reference to 'determined in accordance with this rule'. Hence, where such convertible instrument is issued under an amalgamation or demerger or for consideration in kind, determination of amount received for such instrument may pose difficulty. One may take a view that there is a persuasive case to read these words into the sub-rule to alleviate difficulty.

5.10 Sub-rule (12): Shares in demat form

If shares are held in dematerialised form and the same cannot be distinctly identified, amount received by the company shall be amount received for issue of such shares *determined as per this rule on the basis of the first-in-first-out method.*

- Once the shares are dematerialized their physical identity is lost. If these shares are issued at different points of time at different consideration, then for the purpose of computing the amount received, FIFO is to be applied. Hence the shares that were first issued ought to be considered first and so on.

- In a case where such FIFO basis result in higher outgo of buy-back tax, it may be possible to explore whether shares can be rematerialised in physical form a nd then the physical shares are tendered under buy-back as considered appropriate.

5.11 Sub-rule (13)

Residual cases: In any other case which is not covered above, amount received by the company shall be face value of the share.

Analysis

- This is a residuary sub-rule and will apply where issue of shares is not covered under any of the above sub-rules. There might not be too many situations in which the residual rule may be triggered. However, one example may be corporatisation or demutualisation of stock exchange where the shares are issued to members in lieu of membership rights. Accordingly, the face value of such shares shall be deemed to be amount received by the company.

- Extreme care needs to be taken to ensure that determination of amount received is covered under any of the specific sub-rules. If the residual sub-rule is triggered, it deems the face value as amount received, which may create hardship in many cases.

- Further, in cases where more than one sub-rule applies as discussed above, such cases might get covered under sub-rule (13) in absence of any clarification.

6. Non-applicability of S. 115QA

6.1 Buy-back of shares of a foreign company

S. 115QA deals only with buy-back of shares of domestic companies. Thus, where shares bought back are of a foreign company whether or not the Place of Effective Management (PoEM) of such company is in India, the normal capital gains provisions read with relevant tax treaty provisions shall continue to govern taxation of such buy-backs.

6.2 Buy-back of shares listed on a recognized stock exchange

6.2.1 S. 115QA applies to shares which are not listed on a recognized stock exchange. Accordingly, the normal capital gains provisions shall continue to govern taxation of buy-back of the listed shares. Further, the provisions of buy-back are *qua* listing of shares and not *qua* listing of companies. Thus, if a listed company has its equity share listed but preference shares unlisted, the provisions of S. 115QA will very well be applicable to unlisted preference shares of such listed company.

6.2.2 Further, the term "recognized stock exchange" is not defined u/s. 115QA. However, Explanation 1 to S. 43(5) defines recognized stock exchange as a recognized stock exchange as referred to in S. 2(f) of the Securities Contract Regulation Act, 1956 ("SCRA") and which fulfils conditions prescribed by the Central Government. Accordingly, National Stock Exchange/ Bombay Stock Exchange/MCX Stock Exchange/United Stock Exchange of India Limited are recognized stock exchanges and buy-back of shares listed only on these stock exchanges will be excluded. Buy-backs undertaken by domestic companies whose shares are listed on other stock exchanges or internationally accepted foreign stock exchanges like Nasdaq, NYSE etc. will be subject to buy-back tax.

7. Specific Issues

7.1 Constitutional Validity of Chapter XII-DA

There do not appear to be any reported case laws where the constitutional validity of the Buy-back tax has been considered. However, the Constitutional validity of dividend distribution tax u/s. 115-O has been upheld in Jayshree Tea and Industries Limited - 253 ITR 608 (Cal).

7.2 Buy-back of Preference shares

Redemption of the Preference shares is governed by S. 55 of the Companies Act, 2013, whereas buy-back of shares is governed by S. 68 of the Companies Act, 2013. S. 55 specifically restricts its scope to 'Preference shares' whereas S. 68 mentions the word 'shares', thereby including Equity as well as Preference shares. Thus, it can well be inferred that redemption and buy-back of Preference shares are two separate concepts and S. 115QA would cover buy-back of preference shares dealt with by S. 68 of the Companies Act, 2013. Redemption of Preference shares may continue to be charged as capital gains in the view of the decision of the Supreme Court in case of *Anarkali Sarabhai vs. CIT 224 ITR 422*.

7.3 Whether reduction of share capital is a buy-back?

As per S. 66 of the Companies Act, 2013, a company may, by a special resolution reduce share capital in any manner including by (a) extinguishing or reducing liability in respect of shares not paid-up or (b) cancel paid-up capital which is lost or not represented by available assets or (c) pay off any share capital in excess of its requirements. However, a capital reduction scheme in which share capital is paid-up/extinguished may not be regarded as a buy back so as to be covered by the provisions of S. 115QA. The same will be governed by provisions of deemed dividend u/s. 2(22)(d) and liable for capital gains in the hands of the shareholders.

7.4 Whether a buy-back under a compromise or arrangement u/s. 230 covered u/s. 115QA

It may be possible that a company may enter into a compromise or arrangement with its shareholders u/s. 230 involving a buy-back of its shares. As per S. 230(10) of the Companies Act, 2013, any compromise or arrangement involving buy-back of securities must be in accordance with S. 68 of the Companies Act, 2013 (buy-back provisions). Pursuant to amendment in the Finance Act, 2016, S. 115QA of the Act has been widened the definition of term "buy-back" to include purchase by company of its shares under any law relating to companies. As a result, purchase by the Company of its shares in pursuance of a compromise or arrangement u/s. 230 would get covered and tax u/s. 115QA will be required to be paid on such buy-back.

7.5 Whether buy-back tax is creditable in hands of shareholders under tax treaties?

7.5.1 The buy-back tax will be levied on the Indian company making the share buy-back. The income arising to non-resident shareholder in India will be exempt u/s. 10(34A). However, the non-resident may continue to be liable in his country of residence in respect of the buy-back proceeds received. Whether such buy-back tax paid by the company can be claimed as a tax credit in the hands of the shareholders under the DTAA needs to be considered.

7.5.2 Buy-back tax is an additional tax in the hands of the company and is not withholding tax on the dividends paid or distributed income so paid to the shareholders. Hence it seems difficult that the same may be available as a credit in the hands of the non-resident shareholders.

7.5.3 Many tax treaties/Domestic laws of many countries provide mechanism for claiming tax credit in respect of underlying tax paid in the source country on the profits out of which the income was distributed. Different treaties provide varying threshold for the extent of shareholding of the non-resident shareholder for such underlying tax credit. In case of India-USA DTAA and India-UK DTAA it is 10%, in case of DTAA with Mauritius, Singapore etc., it is 25%. Accordingly, a mechanism to claim credit in respect of buy-back tax in respect of income distributed under a buy-back can be explored. This could be evaluated either in terms of the provisions of underlying tax credit under certain DTAA's or depending on the domestic tax laws of the non-resident shareholder where underlying tax credit may be available for the foreign sourced income.

7.5.4 Further, many tax treaties define 'Indian tax' as **income-tax** imposed under the Act. Tax on buy-back u/s. 115QA of the Act is an additional **income-tax** levied on the companies under the Act and hence, tax on buy-back can be considered as covered by the definition of Indian Tax as per the tax treaties.

7.6 Whether S. 56(2)(x) applicable to the company undertaking buy-back?

7.6.1 As per S. 56(2)(x), if any person receives any property for a consideration which is less than aggregate FMV of the property by an amount exceeding fifty thousand rupees, the aggregate FMV of such property as exceeds consideration shall be taxed under the head 'Income from other sources'. Shares and securities are included in definition of 'property' u/s. 56(2)(x) read with S. 56(2)(vii).

7.6.2 However, for the following reasons, a company undertaking the buy-back of shares at lesser than the FMV should not be liable for tax u/s. 56(2)(x):

1. Under the Companies Act, 2013, company undertaking a buy-back of shares has, under law, to compulsorily extinguish and destroy the shares so bought back within 7 days from date of buy-back. Thus, it cannot be said that company acquires shares in its own right;

2. The term 'property' is defined u/s. 56(2)(x) read with Explanation (d) to S. 56(2)(vii) as

   "property means the following capital asset of the assessee namely…"

From the definition, it is very clear that the 'property' must be a capital asset for the assessee. The shares bought-back by the company which are to be extinguished, cannot be considered as a capital asset of the Company.

Accordingly, shares bought-back by the company do not come within the definition of the term 'property' and hence, S. 56(2)(x) will not be applicable to such company.

7.7 Whether buy-back of Employee Stock Options covered?

7.7.1 S. 68 of the Companies Act, 2013 covers buy-back of shares and other specified securities. As per Explanation I to S. 68, other specified securities include Employee Stock Options. Hence, a company may buy-back unexercised ESOPs. Thus, it is pertinent to discuss whether buy-back of Employee Stock Options is covered u/s. 115QA of the Act.

7.7.2 S. 115QA of the Act covers only buy-back of shares. The term 'share' has not been defined under the Act. As per S. 2(84) of the Companies Act, 2013, "share" means a share in the share capital of a company and includes stock. Thus, options or similar employee ownership rights cannot be regarded as 'share' of a company and accordingly, S. 115QA will not be applicable to buy-back of options of an employee of the company. The employees will be taxable on the gains so received.

7.8 What if distributed income is negative?

Consider a case where the consideration paid by company on buy-back is less than the amount received by the company for issue of such shares. In such a case, distributed income will be negative and no tax u/s. 115QA will be payable by the Company. However, the Company will not be able to set off such negative distributed income against its taxable profits.

7.9 Aggregation of buy-back of shares issued at different prices

Consider a case where the company buys back shares, issued at different prices, say ₹ 10 and ₹ 100, at the same buy-back price, say ₹ 50. In such a case, distributed income will be positive in case of shares which have been issued at ₹ 10 and distributed income will be negative in case of shares issued at ₹ 100. The question arises whether the buy-back tax u/s. 115QA ought to be paid on an aggregate basis i.e. after setting off the negative and positive distributed income. The charging section u/s. 115QA(1) refers to buy-back of shares from a 'shareholder' which may indicate that the charge is *qua* each shareholder. However, such buy-back tax is payable on the distributed income. The term 'distributed income' is defined in Explanation (b) to S. 115QA to mean consideration paid by the company on buy-back of **shares** (in plural). It can be argued that each buy-back results in distribution of income inviting charge u/s. 115QA and not individual distribution *qua* each shareholder. Further, the term 'a shareholder' as used in S. 115QA(1) can be construed to mean 'shareholders' since singular includes plural as laid down in S.13 of General Clauses Act and as held so by the Karnataka High Court in case of Khoobchand M Makhija (223 Taxman 189) and in case of K. G. Rukminiamma (331 ITR 211).

7.10 Applicability of S. 50CA in hands of shareholders

As per S. 50CA of the Act, where the consideration received as a result of the transfer by an assessee of share of a company being other than quoted share, is less than the FMV of such share, the FMV shall be deemed to be the full value of consideration received as a result of such transfer. Any income arising to an assessee, being a shareholder, on account of buy-back of shares as referred to in S. 115QA is exempt u/s. 10(34A) of the Act. Since the income is itself exempt, the question of applying S. 50CA to determine the full value of consideration should not arise. Hence, S. 50CA should not apply to buy-backs covered u/s. 115QA.

7.11 Inability to set-off losses or avail roll over exemptions on capital gains tax for shareholders

Buy-back u/s. 115QA is exempt in the hands of shareholders. Hence, shareholders who have unabsorbed or current capital losses will not able to set-off such losses against potential capital gains arising as a result of transfer via buy-back. Similarly, no indexation will be available. Also, the shareholders will not be entitled to exemption u/s. 54EC or S. 54F on the gains. In such cases alternatives other than buy-back can be considered.

7.12 Whether the shareholder can still claim the benefit of losses arising under a buy-back covered u/s. 115QA may be an interesting one. Following the decision of the Mumbai ITAT in the case of Raptakos Brett & Co. [2015] [44 CCH 231], which held that long-term loss on listed equity shares liable for STT is still deductible, one can similarly try and argue that only income arising from buy-back is exempt u/s. 10(34A) and the loss if any can be set-off.

8. Conclusion

Amendments to S. 115QA of the Act *vide* Finance Act, 2016 have provided much needed clarifications and have put to rest many issues encountered earlier. However, many practical issues as discussed above may need further clarification. Further, the said amendments are applicable from 1st June, 2016 and hence, taxation of buy-back undertaken up to 1st June, 2016 could be a challenge. The buy-back tax provisions being relatively new, there are no judicial precedents. Hence, it might be some time before Tribunals and courts lay down the jurisprudence on the buy-back tax provisions.


Subramaniam Krishnan
Mamta Shroff

Dividends – Alternative Investment Funds

Background

Alternative Investment Funds ("AIFs") as a domestic pooling vehicle was introduced in the year 2012 by the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 ("the Regulations"). An AIF has been defined as a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership ("LLP") or a body corporate which is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of its investors. Under the Regulations, there are three categories of AIFs:

- Category-I AIF – which invests in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the Government or regulators consider as socially or economically desirable. This category includes venture capital funds, SME funds, social venture funds, infrastructure funds and such other AIFs as may be specified.
- Category-II AIF - which does not fall in Category-I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements. AIFs such as private equity funds or debt funds for which no specific incentives or concessions are given by the government or any other regulator are included in this category.
- Category-III AIF – which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. AIFs such as hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended and for which no specific incentives or concessions are given by the Government or any other regulator are included in this category.

Sections 10(23FBA), 10(23FBB), 115UB and 194LBB of the Income-tax Act, 1961 ("Act") encapsulates the code for Taxation of income/gains derived by Category-I and Category II AIFs. As such, there are no specific provisions for taxation of Category-III AIFs; therefore, taxation of such AIFs are governed by the provisions of the Act relevant to the legal form of the AIF (i.e., company, trust, LLP, etc.).

Conceptually, for Category-I and Category-II AIFs, pass-through basis of taxation applies to income other than business income. This chapter explores taxation of dividends received by all categories of AIFs on investments made by them in their portfolio companies.

Dividend income earned by Category-I and Category-II AIFs

As per section 10(23FBA) read with section 115UB of the Act, any income (other than business income) earned by Category-I and Category-II AIFs shall be exempt in their hands and shall be chargeable to income-tax directly in the hands of the investors in the same manner as if it were the income accruing or arising to, or received by, such investor had the investments been made directly by the investor.

Accordingly, dividend income earned by a Category-I/ Category-II AIF is exempt in its hands under section 10(23FBA) of the Act.

As regards taxability in the hands of the investors, section 10(34) of the Act provides that any income by way of dividends received from domestic companies which are subject to dividend distribution tax under section 115-O of the Act, is exempt in the hands of the shareholders with an exception that certain dividends may be chargeable to tax in accordance with section 115BBDA of the Act.

Section 115BBDA of the Act provides that where the total income of an assessee, being a 'specified assessee', who is resident in India includes any income by way of dividend from a domestic company or companies in aggregate exceeding ₹ 10 lakhs, a tax shall be levied at the rate of 10% (excluding surcharge and education cess) on gross basis. Specified assessee has been defined to mean a person other than (i) a domestic company; (ii) a fund or institution or trust or any university or other educational institution or any hospital or other medical institution as referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10; and (iii) a trust or institution registered under section 12A or section 12AA.

Given the above, dividend income accruing to investors of Category-I and Category-II AIFs on a pass through basis should be exempt under section 10(34) of the Act. However, in case of resident investors (other than those specifically exempted), the provisions of section 115BBDA could trigger in which case, aggregate dividend income over and above ₹ 10 lakhs will be subject to a tax of 10% (plus applicable surcharge and education cess).

It should be noted that the provisions of section 115BBDA are applicable only to residents in India and accordingly, these provisions will not apply to non-resident investors of the AIF.

Separately, given the manner in which 'specified assessee' has been defined, an issue could be raised as to why an AIF should not be taxable in its own hands on dividends received in aggregate exceeding ₹ 10 lakhs. In this regard, a view may be taken that as AIF rely on a general exemption under section 10(23FBA) of the Act (which states that any income of an investment fund other than the business income is exempt), the same should override the provisions of section 115BBDA since the provisions of section 10(23FBA) are specific to AIFs.

Dividend income earned by Category-III AIFs

As regards a Category-III AIF, irrespective of the manner in which it is set-up, dividend income should be exempt under the provisions of section 10(34) of the Act except in the cases where the provisions of section 115BBDA of the Act trigger.

In case of a Category-III AIF, the applicability of provisions of section 115BBDA of the Act will need to be analysed on a case to case basis.

Where the Category-III AIF is set-up as a company, the provisions of section 115BBDA should not apply given that domestic companies are specifically exempt from applicability of section 115BBDA of the Act.

Further, where the Category III AIF is set-up as an LLP, the provisions of section 115BBDA could trigger and the LLP will be required to discharge additional tax of 10% on dividend exceeding ₹ 10 lakhs. The share of profits distributed by LLP to the investors being partners in the LLP will be exempt under the provisions of section 10(2A) of the Act. Therefore, there should be no further tax in the investors' hands on receipt of such dividends as part of the LLP's profit distribution.

In a scenario where the Category III AIF is set-up as a trust, the applicability of provisions of section 115BBDA will depend on the manner in which the trust is formed and contribution raised from investors are structured.

- Where the contributions from investors are structured as revocable transfers, as per section 61 of the Act, the beneficiaries/ investors would be liable to tax on the income arising from such revocable transfer. Accordingly, the provisions of section 115BBDA of the Act will need to be analysed in the hands of each of the beneficiaries.
- Where the contributions from investors are structured as irrevocable transfers, the taxability depends on whether the trust is considered as a determinate trust or an indeterminate trust.

In the context of an AIF, ascertaining whether the AIF trust qualifies as a determinate or indeterminate is a complex matter and would depend on the individual facts and fund design.

In case based on the determination, the trust qualifies as a determinate trust, as per section 161 of the Act, the trustee would be liable to tax in its capacity as a representative assessee in a "like manner and to the same extent" as that of the beneficiaries. Accordingly, where a Category-III AIF is set-up as a determinate trust, technically, the computation needs to be made in a "like manner and to the same extent" for each of the beneficiaries and aggregate tax so determined needs to be discharged by the trustees of the trust accordingly. This determination should technically also include whether the beneficiary is, in aggregate in a year, earning dividends from domestic companies exceeding ₹ 10 lakhs. Practically, given the difficulties in ascertaining/ validating the beneficiaries' total income, the trustee may choose to discharge 10% tax on the entire amount of dividend income earned.

In case a trust qualifies as an indeterminate trust, section 164 of the Act provides that the tax shall be charged on the relevant income or part of the relevant income at the maximum marginal rate (MMR).

Where the provisions of section 115BBDA are sought to be applied, a question could arise as to the rate that should apply. As discussed above, an indeterminate trust is subject to tax at MMR. MMR is defined as the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, association of persons or as the case may be, body of individuals as specified in the Finance Act of the relevant year.

One view is that since MMR is specifically defined under the Act, the dividend income exceeding ₹ 10 lakhs should be taxable at MMR as defined. This view has been supported by the Authority for Advance Rulings in the case of *AIG [1997] 224 ITR 473.*

The AAR on the specific issue of applicability of tax rates between section 112 and section 164, stated applicability of section 164 in preference to section 112. However, another view could be that MMR as specified under section 164 of the Act is a general rate as against 10% rate as specified under section 115BBDA of the Act which is a more specific rate to the given stream of income. Since the trustee is taxable as a representative assessee, the assessment on the representative assessee represents the assessment of beneficiaries and *vice versa*. Accordingly, the beneficiaries who would have directly earned the income would have been subject to tax at 10% (plus applicable surcharge and education cess) *vis-à-vis* the beneficiaries investing in a trust classified as an indeterminate trust.

Minimum Alternate Tax ("MAT")/ Alternate Minimum Tax ("AMT") in the case of dividend income earned by AIFs

MAT applicability

As per section 115JB of the Act, dividend income exempt under section 10(34) of the Act is required to be reduced from "book profits" as referred to in the said section and correspondingly, expenses incurred in relation to earning such income are required to be added back to the "book profits". Accordingly, dividend income does not fall within the purview of MAT.

AMT applicability

As per section 115JC of the Act, if the tax payable by a non-corporate entity is less than 18.5% of the adjusted total income, it will be required to pay AMT at 18.5% (excluding applicable surcharge and education cess) of the adjusted total income to be computed in the prescribed manner. The provisions of AMT are applicable to non-corporate assessees that have claimed a deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C.—Deductions in respect of certain incomes", or section 10AA or section 35AD of the Act.

Considering the above, a non-corporate investor in an AIF claiming deductions as specified would need to analyse applicability of AMT to dividend income. Where a Category-III AIF is set-up as a non-corporate entity, the provisions of section 115JC ought not to trigger as typically a Category-III AIF would not be claiming the specified exemptions.

Applicability of section 14A to dividend income earned by AIFs

Section 14A of the Act provides that for the purpose of computation of income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act. Accordingly, where dividend income is exempt under section 10(34) of the Act, the applicability of provisions of section 14A will need to be analysed.

In the context of AIFs, it could be argued that the primary motive of investments is to earn long-term appreciation or exit gain and hence, earning dividend income is incidental and no specific expenditure is incurred for earning the dividend income. Further, typically, expenses incurred by AIFs such as management fees, normal operating and administrative fees (other than those specifically incurred in relation to the deal) are not claimed as deduction in which case, disallowance under section 14A is not warranted. However, where expenditure is claimed in relation to any source of income derived by an AIF, the disallowance of expenditure under section 14A may apply.

Withholding tax by AIFs on dividend income distributed to the investors

As per the provisions of section 194LBB of the Act, Category-I and Category-II AIFs are required to deduct tax @ 10% on all income (other than business income) payable to resident investors at the time of credit or payment, whichever is earlier. In the case of non-resident investors, taxes shall be deducted on the income chargeable to tax under the Act, at the applicable rate in force or rate as per applicable tax treaty, whichever is more beneficial. Investors could obtain NIL/lower withholding certificates from the tax authorities to receive income from Category-I/Category-II AIFs without/at reduced tax withholding rate.

Considering the above, on a literal reading of the law, Category-I and Category-II AIFs are required to withhold tax from distributions to resident investors irrespective of the share of income being exempt under the provisions of the Act. As against this, in case of non-resident investors, the provisions require tax to be withheld at the applicable rates in case of taxable income only.

However, even in the case of resident investors, it could be argued that the provisions of section 204(iii) of the Act, casts an obligation on person who is responsible for making payment to withhold tax in case of "sum chargeable under the provisions of the Act". On this basis, it could be argued that the withholding tax provisions should not apply to dividend income, which is exempt from tax (albeit taxable in certain situations).

In case of Category-III AIFs, the Act does not specify any requirement to withhold tax. Accordingly, the payer of the income (i.e., the portfolio entities in which the Category-III AIFs invest) are required to analyse the withholding tax requirements. Considering that the dividend income is exempt, there ought not to be any withholding tax requirements for the portfolio companies. Even in a scenario where the provisions of section 115BBDA trigger, the provisions of the Act do not cast an obligation to withhold tax in relation to the same.

Dividend distributions by AIFs

Category-I/Category-II AIFs

In the context of Category-I and Category-II AIFs, section 115UB(5) of the Act states that the provisions of Chapter XII-D, which includes sections 115-O and 115R of the Act, shall not apply to the income paid by Category-I and Category-II AIFs.

Category-III AIF

Where a Category-III AIF is set-up as a company, the provisions of section 115-O of the Act would apply to the distributions made by the AIF.

Dividends received from offshore portfolio companies

As per the guidelines issued by the Securities and Exchange Board of India on investing in overseas portfolio companies, an AIF can only invest in equity and equity linked instruments of offshore venture capital undertakings subject to certain conditions. An offshore venture capital undertaking has been defined to mean a foreign company whose shares are not listed on any recognised stock exchange in India or abroad.

Where dividend income is received by the AIF from overseas portfolio companies, the taxability of such dividend income will be as follows –

- Category-I/Category-II – the taxability will need to be analysed in the hands of the respective investors. In case of resident investors, dividend income could be taxed at 30%/40% depending on the characterisation of the investor. In case of non-resident investors, there could be an issue on whether the source of income is outside India or in India. While the dividend is declared by an entity outside India and hence, to that extent the source of such dividend income is outside India, a view also exists since the income stems from investment in an AIF and the first receipt of the income is in India (in AIF's Indian bank account), the source is such investment and hence, the dividend income should be taxable in India. Separately, one will also need to analyse the provisions of an applicable Double Taxation Avoidance Agreement, if any, to conclude on taxability in India of such dividends.

Withholding tax obligations as discussed above will apply to AIFs.

- Category-III AIF – The taxability of the dividend income earned by a Category-III AIF from its overseas portfolio companies will depend on the manner in which the AIF is set-up.

  Where the AIF is set-up as a company, the dividend income is taxable at 30% (plus applicable surcharge and education cess) unless the provisions of section 115BBD trigger in which case the dividend income is taxable at 15% (plus applicable surcharge and education cess) [the amount of dividend subject to tax under section 115BBD is allowed to be reduced from dividends declared by the company and subject to dividend distribution tax under section 115-O of the Act].

  Where the AIF is set-up as a limited liability partnership, the dividend income is taxable at 30% (plus applicable surcharge and education cess).

  Where the AIF is set-up as a trust, the taxability of dividend income earned from the overseas portfolio companies would depend on the manner in which the trust is set-up as discussed above, i.e., in the case of revocable contributions, dividend will be taxable in the hands of the respective beneficiaries (for non-resident beneficiaries, discussions in relation to source of income will equally apply), in case of a determinate trust, computation will need to be made for each beneficiary and liability determined accordingly (i.e., in "like manner and to the same extent") and in case of an indeterminate trust, the dividend income will be taxable at MMR.

Concluding remarks

Taxability of dividend income for investors in Category-I and Category-II AIFs will need to be analysed in the hands of the investors, given that Category-I and Category-II AIFs are exempt under section 10(23FBA) of the Act. Dividend distribution tax under section 115-O is not applicable for Category-I and Category-II AIFs. However, the distributions by Category-I and Category-II AIFs are subject to withholding tax provisions.

Taxability of dividend income for investors in Category-III AIFs is dependent on the manner in which the AIF is set-up. Dividend distribution tax under section 115-O could apply in case of Category-III AIF where the same is set-up as a corporate entity.


Shabala Shinde & Prashant U. K.*

Dividend Implications on Demerger and De-corporatisation

Businesses have always resorted to restructuring options to stay competitive, gain an edge over competition, harness new opportunities, consolidate, to meet statutory or regulatory requirements or to unlock shareholder value. Over the years, tax laws have also evolved, enabling businesses to achieve tax efficient structuring.

Tax neutral demergers[1] have been widely used to separate non-core businesses or to consolidate core businesses into a single entity. Apart from non-core businesses, loss making or non-performing business units are also transferred to a separate entity to enhance shareholder value and maximize returns. With the introduction of 'Limited Liability Partnerships' (LLP) as a new legal entity form, which provides ease of administration with minimal governance and compliance requirements, many businesses have opted to convert from limited company to an LLP (de-corporatization).

While the Income-tax law [Income-tax Act, 1961 (the Act)] contains provisions for tax neutral demergers, it does not specifically provide for taxability where the demerger is not in accordance with the provisions of the Act (taxable demerger), which results in tax implications for the transferor company as well as the shareholders of the transferor company. Similarly, for conversion of company to LLP, the Act contains provisions for tax-neutral conversion; however, if the de-corporatization does not meet the conditions prescribed under the Act, the profits and gains from such transfer is deemed to be the profits and gains chargeable to tax in the hands of the successor LLP or the shareholders of the predecessor company.

Both, taxable demerger and de-corporatization have tax implications for the shareholders of the transferor company; in absence of specific provisions in the Act, the taxability of such taxable demerger and de-corporatization poses challenges for taxpayers. In this article, we have limited our discussion to the dividend implications for shareholders arising on taxable demerger and de-corporatization.

1. Taxable demerger

Section 47(vib) of the Act, specifically exempts any transfer, in a demerger, of a capital asset by the Demerging Company (Transferor Company or Demerging Company, say A Co) to the resulting company (Transferee Company or Resulting Company, say B Co), if the resulting

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1. Transfer of a business undertaking comprising of assets and liabilities at book value to another entity in consideration of issue of shares to the shareholders of the transferor company

company is an Indian company. Consequently, such transfer of a business undertaking is not subject to capital gains tax under section 45 of the Act. Similarly, issue of shares by the Resulting Company to the shareholders of Demerging Company is also regarded as an exempt transfer; and distribution of shares pursuant to a demerger by the Resulting Company to the shareholders of Demerging Company is specifically excluded from the definition of dividend as provided in section 2(22) of the Act. These benefits, i.e. exemption from capital gains tax and exclusion from dividend income is only if the demerger satisfies the following conditions prescribed under section 2(19AA) of the Act:

- All the assets and liabilities forming part of the undertaking are transferred to the Resulting Company, B Co at the book value appearing in the books of the Demerging Company, A Co;
- B Co issue shares to shareholders of A Co on a proportionate basis;
- The transfer of the undertaking is on a going concern basis; and
- Shareholders of A Co, holding three-fourths in value of shares of A Co, become shareholders of B Co by virtue of the demerger.

The aforesaid conditions may not always be satisfied if the consideration for demerger is discharged totally or partially in cash to the Demerging Company or to the shareholders of Demerging Company, or if the transfer of assets/ liabilities is not at book value. In such instances where the prescribed conditions are not satisfied, the issue of shares by the Resulting Company to the shareholders of Demerging Company will not be excluded from the definition of 'dividend' and may be subject to tax as 'dividend' to the extent the Demerging Company possesses accumulated profits. However, it may be noted that for taxing the shares issued by the Resulting Company to the shareholders of the Demerging Company as dividend, it is essential that such issue of shares satisfies the definition of 'dividend' as provided under section 2(22) of the Act.

1.1. Dividend as defined in section 2(22) of the Act

Section 2(22) of the Act defines 'dividend' in an inclusive manner. There are two categories of dividends which could fall within this definition; firstly, 'dividend' as is commonly understood in the ordinary sense and, secondly, those items which have been explicitly provided by way of inclusions. The dictionary meaning of dividend is *'a sum of money paid regularly (typically annually) by a company to its shareholders out of its profits (or reserves)'*. The term dividend therefore connotes something which is distributed by the company in accordance with provisions of the Companies Act, 2013. Hence, to be taxable as 'dividend' as is understood commonly, (i) there has to be a distribution by the company; (ii) the distribution has to be to its shareholders; and (iii) the distribution has to be made out of profits of the company. The items which have been explicitly provided by way of inclusions are referred to as 'deemed dividend' and are subject to tax as dividend only if the conditions prescribed in clauses (a) to (e) of section 2(22) are satisfied.

- ***Taxable Demerger whether results in distribution of 'dividend' in the ordinary sense***

A taxable demerger may give rise to dividend income in the hands of shareholders, if there is distribution of profits by the Demerging Company to its shareholders. However, it is to be noted that in a demerger there is no real distribution by the Demerging Company to its shareholders. In instances where the consideration for demerger (either in part or in full) is discharged by the Resulting Company to the shareholders of Demerging Company either in cash or by issue of shares, one may argue that it is a constructive payment by the Resulting Company on behalf of the Demerging

Company and therefore, in the nature of dividend. However, this argument may not be tenable as various judicial precedents have held that dividend in the ordinary sense denotes distribution by the company to its shareholders. In case of demergers where consideration is discharged by the Resulting Company through cash pay-out or issue of shares to shareholders of Demerging Company, there is no distribution by the Demerging Company to its shareholders out of profits. Hence, in absence of any specific inclusion for such distribution to be deemed as dividend, it may not be possible to tax the cash pay-out or issue of shares by the Resulting Company, as dividend, in the hands of the shareholders of the Demerging Company.

It is important to note the Supreme Court's decision in case of *Kantilal Manilal and Ors. vs. The Commissioner of Income Tax 1961 SCR (2) 584* wherein the Hon'ble Supreme Court held that the distribution of the 'right to apply for and obtain two shares of Bank of India' (at half their market value) for each share held by the shareholders of the Mills, was distribution of dividend. In the case of Kantilal Manilal (supra), it is to be noted that there was distribution of 'right to apply for share'; whereas in case of a demerger, the issue of shares by the Resulting Company is in consideration of the transfer of the undertaking and the Demerging Company does not distribute or grant to its shareholders any right to acquire shares of the Resulting Company.

The 'constructive payment' argument may result in regarding the taxable demerger as a two-step process – first step being distribution of demerged undertaking to the shareholders, taxable as dividend-in-kind. The second step is the transfer of the demerged undertaking by the shareholders to the Resulting Company in exchange of shares, taxable as capital gains or vice versa. This approach of dissecting a legally-sanctioned scheme of demerger and treating the demerger of the undertaking as 'distribution to shareholders' is akin to adopting a 'look through' approach. It is a well-settled principle that a scheme once approved by the National Company Law Tribunal (NCLT), operates by force of the statute and is binding on the company, the creditors and the members. Hence, such a 'look-through approach', which summarily dismisses the NCLT-sanctioned demerger scheme may be regarded as pretentious. However, if the overall arrangement lacks commercial substance, the same could get challenged under the General Anti Avoidance Rules prescribed under the Act, which, if proven correct, would empower revenue authorities to look beyond the legal veil of the scheme to understand the true nature of the arrangement and tax it accordingly.

- ***Whether Taxable Demerger gives rise to 'deemed dividend'***

The amounts explicitly covered as dividend under section 2(22) among others, include 'distribution by a company to its shareholders' to the extent of accumulated profits, if:

- The distribution entails release of all or any part of the assets of the company (clause a);
- There is distribution of debentures, debenture-stock, or deposit certificates in any form and bonus shares to preference shareholders (clause b);
- There is distribution on liquidation (clause c); or
- There is reduction of its capital (clause d).

In case of a taxable demerger, clause (b) and clause (c) will not have any applicability. However, the applicability of clause (a) and clause (d) needs evaluation.

Before discussing the taxability of taxable demerger as 'deemed dividend' it is pertinent to note that deemed dividend as provided in clauses (a) to (d) of section 2(22) is a legal fiction, created by law and needs strict interpretation. Hence, clauses (a) to (d) of section 2(22) will trigger only if (i) the company has accumulated profits; and (ii) the company distributes such profits to its shareholders either by release of its assets, or by distributing debentures, or on liquidation or on reduction of its capital. In other words, clauses (a) and (d) will not be attracted in instances where the company does not have accumulated profits, or has accumulated profits but there is no distribution to its shareholders, or there is distribution of accumulated profits to the shareholders in any manner other than by way of release of its assets, or reduction of capital.

In case of a taxable demerger, section 2(22)(a) of the Act would apply only if there is release of any assets of the Demerging Company to its shareholders; however, in a taxable demerger, the release of assets (undertaking) of the Demerging Company is to the Resulting Company and not to its shareholders. A company is a juristic person and is distinct from its shareholders. Therefore, the transferred undertaking belongs to the Resulting Company which owns it and not to the shareholders, who merely acquire a right to participate in the profits of the resulting company. Thus, in a taxable demerger, the issue of shares or cash pay-out by the Resulting Company to the shareholders of the Demerged Company neither entails release of the assets of the Demerging Company to its shareholders nor is the Demerging Company distributing anything by itself to the shareholders as is required under section 2(22)(a) of the Act.

Reliance in this regard can be placed on the circular issued by the Central Board of Direct Taxes ('CBDT')[2], wherein, while addressing queries on applicability of deemed dividend in case of amalgamation between a parent company and its subsidiary company, clarified that–

> *"section 2(22)(a) is attracted only where (i) a company distributes its accumulated profits to its shareholders, and (ii) such distribution entails the release by the company to its shareholders of all or any part of its assets. However, where a company transfers its assets to another company in a scheme of amalgamation, such transfer may not be regarded as a "distribution" by the company of its accumulated profits to its shareholders even though its accumulated profits are embedded in the assets so transferred by it. This will be clear if one considers a case where, before the amalgamation of two companies, only a part of the shares of the amalgamating company were held by the amalgamated company and the remaining part by other shareholders; in such a case the other shareholders will not receive any part of the assets transferred by the amalgamating company to the amalgamated company."*

While the above clarification was issued specifically for a parent-subsidiary amalgamation, the principle should clearly apply in case of a taxable demerger as well and it may be possible to argue that even in case of a demerger, the transfer of assets by the Demerging Company to the Resulting Company should not be considered as deemed dividend.

Provisions of section 2(22)(d) should also not apply to a taxable demerger as long as such taxable demerger does not result in reduction of capital of the Demerging Company. Section 2(22)(d) of the Act presupposes two conditions, one there is reduction of capital and two, there is distribution of accumulated profits by the company to its shareholders. In a taxable demerger these two conditions are not satisfied.

In the case of Ajai Chaudhary, the Delhi ITAT[3] concluded that section 2(22)(d) of the Act has no application unless there is reduction of share capital and there is distribution of profits to the shareholders. The ITAT while deciding on revenue's contention to treat the issuance of shares as distribution of dividend under section 2(22)(d) of the IT Act, held as below:

> *"25. It is abundantly clear from the records that the Scheme or Arrangement resulted*

2. Circular No. 5-P dated 9th October, 1967
3. *Ajai Choudhary vs. DCIT (2000) 74 ITD 350 (Delhi ITAT)*

in reorganization of capital. There was no reduction of capital. At para 17 of the High Court's order dated 26-11-1991 it is mentioned "there is really no reduction in capital as the bifurcation involves both the assets and liabilities to go with the divisions which are being spun off." For reduction of capital, Companies Act enumerate procedure laid down in sections 100 to 105. Recourse was not made to this procedure. Hon'ble High Court held this to be an arrangement for reorganization of capital. In effect it resulted in splitting up capital of the company into two companies. There was no reduction of capital in the aggregate. The shareholding of the Individual shareholders were split between two companies. The aggregate of holding of each shareholder in the two companies continued to be the same as was the original shareholding in the parent company.

26. As such the first requisite of S. 2(22)(d) of the Act was not satisfied.

27. We have noted that shares were issued to the assessee by HCL-HP Ltd. These were not issued by HCL Ltd. of which the assessee was the shareholder. In other words, there was no distribution of shares by the parent company. As such, the second conditions laid down under S. 2(22)(d) was also not satisfied.

28. From the aforesaid it is apparent that there was no distribution on the reduction of share capital. Therefore, there was no question of utilization of accumulated profits for the purpose of distribution. As such, in our opinion, the case of the assessee is not coming within the ambit and scope of S. 2(22)(d)."

Therefore, in a taxable demerger, as long as there is no reduction in capital of the Demerging Company, or even if there is reduction in capital there is no distribution by the Demerging Company to its shareholders, the provisions of section 2(22)(d) of the Act would have no application. Further, as discussed above, one may want to argue that demerger is a two-step process. However, such a look-through approach for a NCLT-approved scheme of demerger having a statutory binding effect, would not be a tenable argument. Further, it is to be noted that sections 2(22)(a) and 2(22)(d) of the Act are deeming provisions and must therefore, receive a strict interpretation.

Separately, it is also pertinent to note that in cases involving taxable demerger, the only issue that has come up before the Courts is taxability of the transfer of undertaking in the hands of the Demerging Company as capital gains. The Delhi High Court in the case of Salora International[4] has extensively dealt with revenue's contentions with respect to taxability of the demerger as capital gains in the hands of the Demerging Company. The High Court held that the value of shares issued by MTAIC, the resulting company directly to the shareholders of Salora International would also form part of the total consideration for the purposes of computation of capital gains in the hands of Salora International. One should note that no contention has been put forth by the revenue authorities with respect to taxability of the consideration received by the shareholders of Salora International as dividend income.

The other challenge that may arise in a demerger, is where the Demerging Company is required to follow the Indian Accounting Standards (Ind AS) and the transferor and transferee companies are not under common control. In such cases, Appendix A, *'Distribution of Non-cash Assets to Owners* of Ind AS 10, *'Events after the Reporting Period'*, requires the Ind AS compliant Demerging Company to account for demerger at fair value and record the same as dividend. Further, sections 230 to 232 of the Companies Act, 2013 also require the companies to provide auditor's certificate of compliance with applicable accounting

4. *CIT vs. Salora International (2016) 386 ITR 580 (Delhi)*

standards. Hence, in instances where an Ind AS compliant company demerges its undertaking to a Resulting Company, which is not under common control, the undertaking will have to be demerged at fair value, making it a taxable demerger for the purposes of the Act. The recording of the demerger and the transfer of undertaking as dividend in the books of the Demerging Company will pose a challenge from tax standpoint both, for the Demerging Company as well as the shareholders of the Demerging Company. The Demerging Company will record dividend in its books but not pay any dividend distribution tax, as it will only be an entry in the books and there will be no distribution to its shareholders. Such recording of dividend does not meet the requirements of section 2(22) of the Act and should therefore not be subject to dividend distribution tax. However, given that the Demerging Company recognizes dividend in its books, it may trigger scrutiny from the revenue authorities.

While revenue authorities may initiate scrutiny, the same may not be tenable as the accounting treatment in books of account shall not be decisive of the true nature of the transaction and the book entry of recording the demerger as dividend, in itself should not result in income for the shareholders. Merely accounting the demerger as dividend to comply with the Ind AS regulations would not alter the character of the transaction by itself and the statutory scheme that classifies the transaction to be in the nature of a demerger cannot be disregarded. What really matters is whether such demerger is covered by the specific inclusions provided under section 2(22) of the Act. The analysis in the preceding paragraphs of this article suggests that the demerger consideration received by the shareholders does not fall within the inclusions provided under section 2(22); and therefore, mere recording of the demerger as dividend should not give rise to any tax implications for the Demerging Company or its shareholders.

2. De-corporatization

In the case of de-corporatization - conversion of a company to an LLP – the Act prescribes certain conditions subject to which the conversion is not regarded as a transfer for the purposes of capital gains. Section 47(xiiib) of the Act specifically provides that conversion of company (say, X) to an LLP (say, Y) is not to be regarded as a transfer for the purposes of section 45 of the Act, if the following conditions are satisfied:

- All assets and liabilities of X become assets and liabilities of Y;
- All the shareholders of X become partners of Y and their capital contribution is in same proportion as their shareholding in the company;
- Shareholders of X do not receive any other consideration other than share in profit and capital of Y;
- The aggregate of shareholding of shareholders of X is not less than 50 per cent for five years from conversion;
- The total sales/turnover/gross receipts does not exceed INR 60 lakh during three years preceding year of conversion;
- The total value of assets does not exceed INR 5 crore during three years preceding year of conversion; and
- No amount is paid, either directly or indirectly to any partner out of balance of accumulated profit of X for a period of 3 years from date of conversion.

Section 47A(4) of the Act further provides that if the prescribed conditions are not complied with, the capital gains not charged earlier shall be chargeable to tax in the hands of the shareholder/successor LLP in the year in which the conditions are breached.

De-corporatization, which does not comply with the prescribed conditions, should not give rise to dividend implications for the shareholders as de-corporatization does not result in distribution to the shareholders. The deemed dividend provisions should also not trigger unless such de-corporatization is covered specifically by clauses (a) to (e) of section 2(22) of the Act.

Given the nature of de-corporatization, one may argue that it potentially falls under clause (a) which covers distribution of accumulated profits entailing release of assets or under clause (c), which covers distribution on liquidation of a company. However, de-corporatization not meeting the prescribed conditions would not be covered under either of these clauses in view of the following:

- ***Conversion of company to an LLP does not amount to liquidation of the company***

The CBDT has, in a circular addressing queries with respect to applicability of section 2(22)(c) in the case of parent company-subsidiary company amalgamation, clarified that this provision is attracted only in a case where a company actually goes into liquidation and not where it merges with another company in a scheme of amalgamation without going into liquidation. This principle should be equally applicable in case of de-corporatization as well, where the company converts to LLP without actually going into liquidation.

- ***No distribution by company to its share-holders***

Since there is no actual distribution from the company to its shareholders and there is only a change in entity form, provisions of clause (a) of section 2(22) should not apply. As in case of taxable demerger, one may argue that the conversion is also a two-step process and therefore, there is release of assets of the company, first, to the shareholders and then a subsequent contribution of assets by the shareholders to the LLP. Nonetheless, dividend provisions would not trigger as the Act provides for the manner in which the gains will be subject to tax if the de-corporatization does not meet specified conditions. Adopting this approach of a two-step process, would lead to double taxation of the same 'income'. It is a well-settled position that same income cannot be doubly taxed and therefore, the argument of two-step process would become redundant.

The argument that there is no distribution of profits, may be defeated, if on conversion, the reserves of the company are credited to the individual accounts of the partners. This may also lead to contravention of the conditions prescribed under section 47(xiiib) of the Act, and therefore, result in taxation of the capital gains in the hands of the shareholders of the successor LLP. As discussed above, taxing the conversion again as dividend would lead to double taxation.

3. Conclusion

To summarise, based on the above analysis it is possible that a taxable demerger may not give rise to any dividend implications in the hands of the shareholders of Demerging Company as long as the demerger does not lack commercial substance and there is no distribution by the Demerging Company to its shareholders. Having said this, it is pertinent to note that section 56(2)(x) of the Act only exempts demergers which satisfy the conditions prescribed under the Act; hence, section 56(2)(x) would trigger for the shareholders receiving shares/cash from the Resulting Company. In a taxable demerger, rather than dividend, the shareholders being subject to tax under section 56(2)(x) seems to be a significant issue.

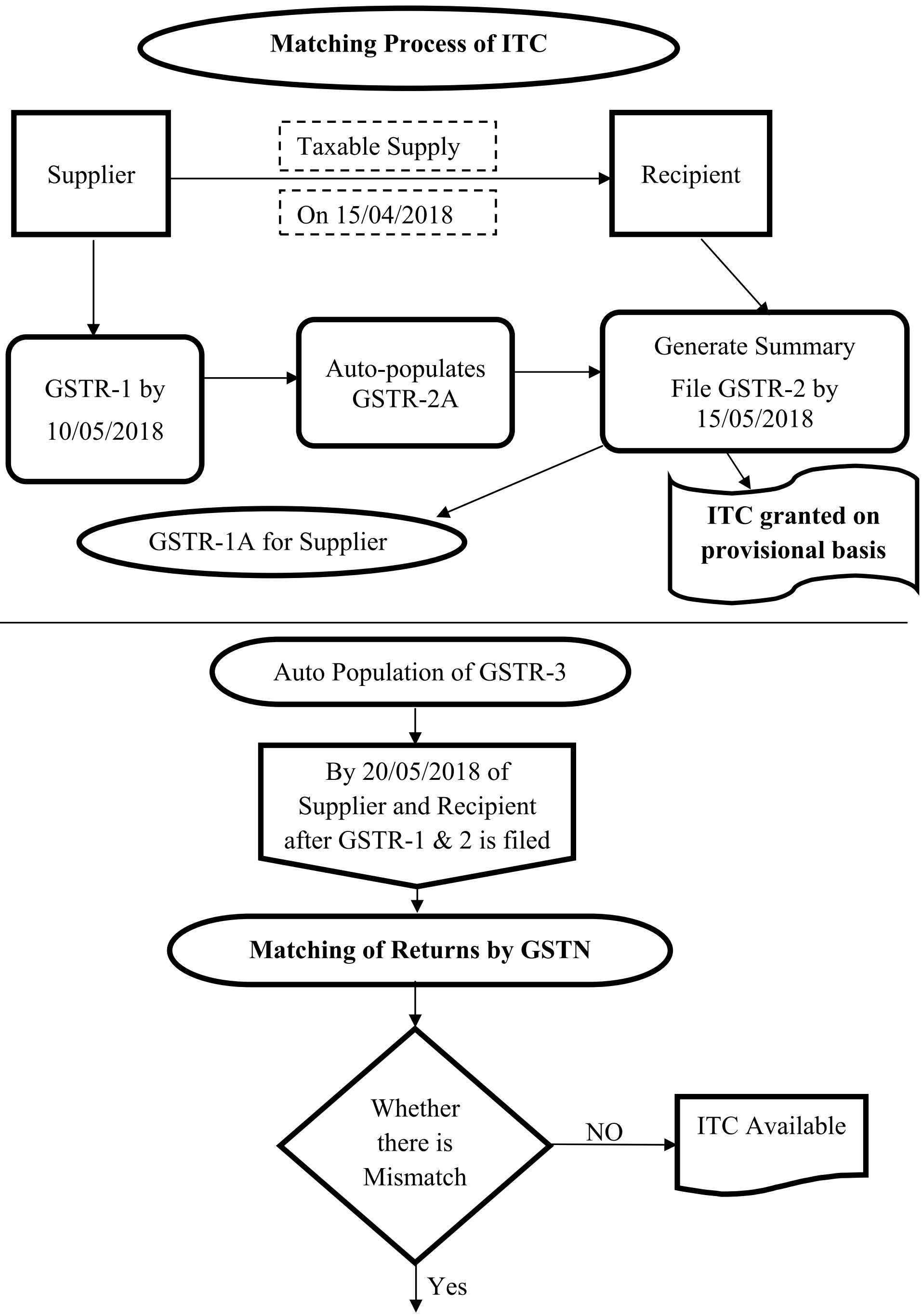
The other important aspect that needs to be addressed is in respect of Ind AS compliant companies entering into demerger schemes with companies where no common control exists. The requirement under Ind AS to record demerger as dividend by the Demerging Company will trigger unwarranted scrutiny from the tax authorities and hence, it is imperative that suitable amendments are made to the Act to set right the unintended consequence of subjecting the Demerging Company to dividend distribution tax.

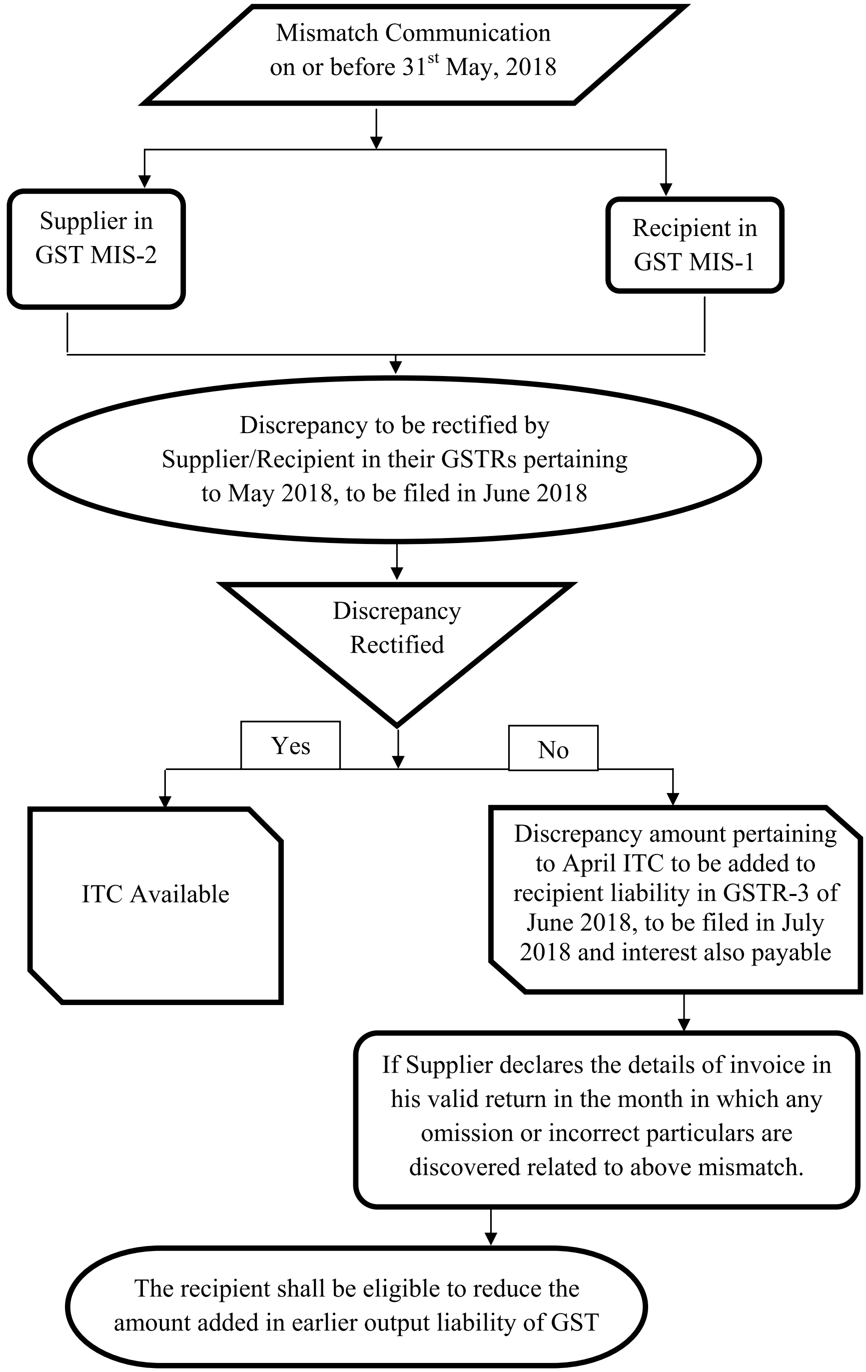
Case Laws Index

ERRATA

In December, 2017 issue of The Chamber's Journal in the article on "Matching Concept under ITC" by CA Jinit R. Shah, inadvertently, the process of matching to be carried out by GSTN chart is partially printed on page 68. Members are requested to read the full Chart as given below. The error is regretted.

"The process of matching to be carried out by GSTN will be as under:





NOTE: The above flowchart depicts what is provided in the law. However, in actual how the system functions and how the process will work can be experienced only after all relevant returns are filed for the month and the communication starts between the GSTN and the assessees.

Radhakishan Rawal[1]

HOT SPOT
The Grass on the Other Side
GST Law as it appears to a direct tax professional

Having spent close to two decades trying to understand the provisions of the direct taxes and tax treaties, the author tries to understand the provisions of the Goods and Services Tax law (GST law).

Basis of charge

Under the provisions of the Income Tax Act, 1961 (ITA) what is subject to tax is "income" and the charge is on the income accruing or arising or deemed to be accruing or arising in India. The circumstances in which the income is deemed to accrue or arise in India is well defined in the ITA, however the circumstances in which the income can be said to be "accruing" or "arising" in India continues to be a puzzle, even after hundred or more years[2] after introduction of the concept. The Legislature has not thought it appropriate to give statutory meaning to these concepts. Similarly, even the judiciary's reluctance in giving clear guidance on these concepts is obvious as they have categorically observed that the findings of the court are specific to the facts and disputes involved[3].

As a result, addressing applicability of section 5 of the ITA i.e., deciding whether the income can be said to be "accruing" in India becomes difficult in certain circumstances. As regards time of accrual, guidance can be availed from the accounting standards.

Under the provisions of the GST law, what is subject to tax is "supply of goods or services or both". The GST law gives definitions of key concepts such as "time of supply of goods", "time of supply of services", "place of supply of goods", "place of supply of service", "location of supplier of service", "location of recipient of service" etc. This suggests that unlike ITA, the GST law gives better statutory guidance on the basic charging provision.

Concept of "service" – Levying tax on anything!

The ITA defines the term "fees for technical services". It does not define the term "services". Accordingly, what constitutes "service" for the purpose of ITA is to be determined on how this term is understood in general parlance.

As against this, the term *"service" under the GST law is defined to mean anything other than goods, money and securities but includes activities relating to the use*

1 Author is a Deloitte Partner. Views expressed if any in the article are personal views of the author.

2 The concept of "accruing" or "arising" existed even in the Income Tax Act, 1918.

3 Chapter 2 – Income Accruing or arising – book titled Taxation of Cross-border Services (2012 – CCH publication) by the author of this article contains detailed analysis of the issue.

of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

Thus service means "anything" other than goods! The concept of "service" under the GST law appears to be abstract. The reason for such strange definition could be the intention to avoid litigation around what constitutes "service". The term "goods" is well defined in the Act and if the definition of "service" is kept wide, it would be possible to levy tax on any type of "transaction" or alternatively it would be possible to levy tax on "anything". In terms of para 5(e) of Schedule II *agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act* shall be treated as supply of service.

This wider scope of the term "service" also appears to be influencing the exemptions. For example *"service by way of transfer of a going concern"* is exempted by Notification No. 12/2017. One may wonder where is the "service" involved or what is the service element when the business undertaking is transferred as a going concern? Whether the fact that the purchaser gets a running business and is able to run the business the moment he becomes the owner is to be seen as "service"?

Supply of "both" goods and services

Under the charging section 9 of CGST Act as well as section 5 of the IGST Act, levy of tax is on supply of "goods or services or both". The words "goods or services or both" are prominently present in the definition of the term "supply", in the charging section and in several other sections of the GST law. However, at the same time, the words "or both" are conspicuous by their absence in several provisions of the GST law.

The terms "goods" and "services" are well defined. However, what qualifies as "both goods and services" is not defined. The circumstances in which "both goods and services" can be said to have been supplied is not clarified. What is the "time of supply of goods" and "what is time of supply of service" is clarified, but what is "time of supply of both goods and services" is not clarified. Similarly, what constitutes "place of supply of both goods and services", "location of supplier of both goods and services" is not clarified. If tax is to be levied on something which constitutes supply of both goods and services, should not these aspects be clarified? The rates at which GST should be levied on something which qualifies as "supply of both goods and services" are also not prescribed.

However, this gets addressed probably in a different manner. There is a concept of "composite supply". Where a supply made by a taxable person consists of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in ordinary course of business, it is treated as a composite supply. One of these is treated as a principal supply and such composite supply (which could be supply of both goods and services) is treated as supply of such principal supply and taxed accordingly.

When two things are supplied together, which one is the principal supply may be difficult to determine in certain transactions and it could be subjective. When a person takes dinner in a restaurant, it would involve food items and services. One may believe that in this case the principal supply should be food item, however Schedule II mandates that this should be treated as supply of service. This could also be attributable to Article 366(29A)(f).

There is also a concept of "mixed supply", supply of one or more goods or service which do not qualify as "composite supply". It is mandated that the mixed supply, shall be treated as supply of that particular supply, which attracts the highest rate of tax.

In the course of furtherance of business

The expression "in the course of furtherance of business" appears to be a critical part of the provision dealing with scope of supply i.e. section 7 of the CGST Act, as it would be logical to charge GST on transactions executed by a person carrying on the business. However, its usage in section 7 of the CGST Act is not consistent and this could create some confusion.

Section 7(1)(a) gets invoked when the transactions are made in the course of furtherance of business. As per section 7(1)(b), import of services for a consideration is treated as supply even if not made in the course of furtherance of business. The balance two clauses of section 7(1), do not use the expression "in the course of furtherance of business". Two paragraphs of Schedule I specifically use this expression, but the other two paragraphs do not use this expression. Various paragraphs of Schedule II also do not use this expression. A press release clarifies that sale of old jewellery by a person not engaged in business will not attract GST.

Transactions before commencement and after closure of business

From the perspective of direct tax laws the date of setting up, commencement and closure of business are of importance. Deduction is not allowed for expenses incurred prior to the date of set up of the business, although depreciation may be available on certain amounts capitalised on assets.

Consistent with the object and purpose of the GST law, the importance of the date of commencement or closure of business can be said to have been diluted. This is because the term is defined in a wide manner to include supply or acquisition of goods including capital goods and services in connection with commencement or closure of business. Thus these transactions could also attract GST.

Establishment, fixed establishment, place of business and permanent establishment

Permanent establishment under the direct tax law

Under the direct tax law, the concept of permanent establishment is one of the important concepts from the perspective of taxation of cross-border transactions. It is essentially a fixed place of business through which business of the enterprise is wholly or partly carried on. With the emergence of new business models and technology, the concept of permanent establishment is under significant stress.

Fixed establishment and place of business under the GST law

Fixed establishment is one of the important concepts under the GST law. This term is defined to mean a place (other than the registered place of business) which is characterised by a sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services, or to receive and use services for its own needs.

The GST law also has a concept of "place of business" which refers to the place from where the business is ordinarily carried on. The term "establishment" is not specifically defined in the CGST Act but its usage in the definition of "location of supplier of service" suggests that "establishment" is a broader term and it could include "a place of business" and "a fixed establishment".

The concept of fixed establishment is relevant only from the perspective of "services" and not when goods are supplied. In the context of supply of goods, the concept of place of business would be relevant. Thus the amalgam of fixed establishment and place of business can be broadly compared with the concept of permanent establishment under the direct tax laws.

Under the direct tax laws, significant guidance is available on what constitutes a permanent establishment and there is also a significant litigation around this. The term "fixed" is interpreted to mean something which is linked to a geographic location and also something which has a reasonable duration / permanence. Generally, a period of 180 days is treated as threshold, however different parameters are applied for repetitive events. The judgment of the Supreme Court in the case of Formula One is the latest on this issue, where the foreign company had access to race circuit for about three weeks and the Supreme Court held that the foreign company had a permanent establishment in India.

The definition of fixed establishment under the GST law itself provides that there should be a "significant degree of permanence". The interpretation of these words could certainly be subjective. This may be broadly comparable to the duration test applicable to a permanent establishment.

Requirement of human intervention

Another important feature of the definition of fixed establishment is that it should represent a suitable structure in terms of human and technical resources for making supply. What constitutes suitable structure will depend on the nature of business. The requirement of human resource is interesting. With the growing influence of technology, automation and artificial intelligence, certain models may not require human resources for making a supply and one may want to argue that in such cases the place cannot be said to be fixed establishment.

The GST law requires presence of human for creation of a fixed establishment, which is a concept in the context of services. Interestingly, under the direct tax laws, the Supreme Court has held that the services must have human element for it to qualify as fees for technical services.

Business through agents

When business is carried on through an agent, the place could constitute a fixed place of business or an establishment under the GST law. The concept of permanent establishment is narrower in this regard for the reason that performance of only certain activities by an agent results in creation of permanent establishment, provided the agent is a dependent agent.

Transactions with self

Based on various judicial precedents[4] it is a well-settled principle that a person cannot trade with himself, cannot earn profits from self. Thus transactions between two branches of the same entity do not generate any profits as it would be mere transfer of funds from one pocket to another.

The ITA relaxes this principle in certain specific circumstances e.g., section 2(47)(v) provides that conversion of capital asset into stock-in-trade is to be treated as "transfer", the taxability of such transfer is however deferred. Section 80-IA(8) also treats transaction between two parts of the same entity a having tax consequences. The recently inserted Explanation to section 9(1)(v) provides that in the case of a banking company, the interest paid by the Indian permanent establishment to its head office outside India is to be treated as interest deemed to accrue in India.

Interestingly, the GST law has a concept of "Distinct person". As per this concept establishments of a person in two different States are to be treated as establishments of a distinct person and the transactions between these two distinct persons would be subject to GST. Similarly, an Indian branch of a foreign company and its head office outside India would also qualify as "distinct person".

Pure agent concept

Under the direct tax law taxability of reimbursement of expenses is a highly litigative issue and there are plethora of judicial precedents dealing with this. The GST law contains a concept of "pure agent". GST is leviable on the "value of supply" and it is provided that the expenditure or costs incurred by a supplier as a pure agent of the recipient of the supply shall be excluded from the value of supply.

Pure agent means a person who –

(a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;

(b) neither intends to hold nor holds any title to the goods or services or both so procured or supplied as pure agent of the recipient of supply;

(c) does not use for his own interest such goods or services so procured; and

(d) receives only the actual amount incurred to procure such goods or services in addition to

4 Chapter 5 – Profits from transactions with self of book titled *Attribution et al*, - Taxation of Permanent Establishment, written by the author of this article examined the issue in greater detail.

the amount received for supply he provides on his own account.

Insertion of concept like pure agent in the direct tax law could significantly reduce litigation.

Absence of GAAR and SAAR

It is interesting to note that while the landmark judicial GAAR (General Anti-Avoidance Rule), *McDowell and Co. vs. CTO [1985] 154 ITR 148 (SC)*, was laid down by the Supreme Court in the case involving indirect tax laws, way back in the year 1985, the GST law does not have provision comparable to the GAAR provisions in the direct tax law. *Prima facie* the GST law also do not appear to have many specific anti-avoidance rules (SAARs). The transactions between the related persons are valued at fair market value, which may be treated as SAAR.

Transfer of business of a going concern

Under the provisions of ITA, prior to the insertion of section 50B levying tax on slump sale, historically the judicial authorities took a view that transfer of business of a going concern basis is not subject to capital gains tax. In absence of availability of consideration for individual item of capital asset involved in such transfer, capital gains cannot be computed.

For the purpose of GST, in terms of Notification No. 12/2017 *"service by way of transfer of a going concern"* is exempted from GST.

Definition of "person"

Definition of the term "person" under the GST law appears to be an improved version of what can be found under the direct tax laws. It has fourteen sub-clauses (as compared to only seven under the definition of person under the ITA) and specifically includes a trust, LLP, Central or State Governments.

Placement of certain provisions

Under the provisions of ITA, the definitions which are relevant for the purpose of the entire Act are placed in section 2. Further, certain definitions relevant for certain chapters or sections are bunched together in a specific section e.g., section 43, section 102 etc. Further, certain definitions which are relevant only for a specific section are placed in such section.

Under the GST law also the definitions which are relevant for the purpose of the entire law are bunched together in section 2. However, there are certain exceptions (or misplacements). For example, the term "related person" is defined in the *Explanation* to section 15 of the CGST Act, but it is defined "for the purpose of this (CGST) Act". Similarly, *Explanation 1* to section 8 of IGST Act deals with "distinct persons", but that is defined for the purpose of the entire Act.

Conclusion

GST is undoubtedly a massive reform and as it happens with any new system there would be teething issues which would be ironed out, hopefully in a short period. However, interpretation of certain provisions could take some time as the very basis of taxation under the GST law has changed. What is taxable is "supply" of goods or services or both. With the change of basis of taxation, new concepts and new language, this could result in fresh rounds of litigation.

Very high quality guidance and literature is available in the form of judicial precedents on the provisions of the ITA and the same is the case with indirect tax laws. Where the provisions of comparable and context permits, the direct tax literature would be useful in interpreting indirect tax laws and *vice versa*.

> The highest manifestation of strength is to keep ourselves calm and on our own feet.
>
> — *Swami Vivekananda*

B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Taxability of subsidies: Supreme Court stays judgment of the Delhi High Court in *CIT vs. Bhushan Steels and Strips* which held that if the recipient has the flexibility of using it for any purpose and is not confined to using it for capital purposes, the subsidy is revenue in nature and is taxable as profits.

M/s. Bhushan Steels Ltd vs. CIT – Petition(s) for Special Leave to Appeal (C) No. 30728-30732/2017, dated 20th November, 2017

The Supreme Court has stayed the judgment of the Delhi High Court in the case *CIT vs. Bhushan Steel and Strips Ltd.*

Before the Delhi High Court, the following question of law was raised:

> *"Whether the ITAT was correct in law in holding that the amount received by the assessee by way of exemption of sales tax payments was not a trading receipt but was a capital receipt, hence not liable to tax?"*

Brief facts before the High Court were that the assessee company was in a business of manufacture of cold rolled/galvanized steel strips and sheets etc., and its two units were located in notified backward area in the State of Uttar Pradesh. As per the notifications issued by the State Government under UP Sales Tax Act, 1948 certain exemptions were granted to the industries set up in backward areas for a period up to 8 years based on fixed capital investments. Initially, the assessee did not take into consideration the subsidy in the form of exemption at the time of filing original return of income. However, the assessee revised its return of income and claimed the said subsidy as capital receipt. However, during the assessment, the claim of the assessee was not accepted by the AO.

Thereafter on appeal, the assessee's claim was allowed by the CIT(A) and also by ITAT.

The High Court considered in detail the following decisions:

- *CIT vs. Ponni Sugars & Chemicals [(2008) 306 ITR 392 (SC)]*
- *Sahney Steel and Press Works Ltd. vs. CIT [(1997) 228 ITR 253(SC)]*
- *CIT vs. Shree Balaji Alloys [(2016) 287 CTR 459 (SC)] confirming the decision of Shree Balaji Alloys vs. CIT [(2011) 333 ITR 335 (J&K High Court)]*
- *CIT vs. Bougainvilla Multiplex Entertainment Centre Ltd. [(2015) 373 ITR 14 (Delhi High Court)]*

The High Court also considered the supplementary notification dated 27-7-1991 issued by the State of UP.

Accordingly, the Delhi High Court held as under:

"25. In the present case, the provisions of the original scheme (i.e., the original policy of 1990) and its subsidy scheme are relevant; they have quite correctly been relied upon by the revenue. Paras 6 (A) and 6(B) of that scheme specifically provided for capital subsidy to set up prestige units; the amounts indicated (Rupees fifteen lakhs) were to be towards capital expenditure. Now, if that was the scheme under which the assessees set-up their units, undoubtedly it contained specific provisions that enabled capital subsidies. Whether the assessees were entitled to it, or not, is not relevant. ***The assessees are now concerned with the sales tax amounts they were permitted to retain, under the amended scheme (dated 27-7-1991) which allowed the facility of such retention, after the unit (established and which could possibly claim benefit under the first scheme) was already set up. This subsidy scheme had no strings attached. It merely stated that the collection could be retained to the extent of 100% of capital expenditure. Whilst it might be tempting to read the linkage with capital expenditure as not only applying to the limit, but also implying an underlying intention that the capital expenditure would thereby be recouped, the absence of any such condition should restrain the court from so concluding****.*

26. How a State frames its policy to achieve its objectives and attain larger developmental goals depends upon the experience, vision and genius of its representatives. Therefore, to say that the indication of the limit of subsidy as the capital expended, means that it replenished the capital expenditure and therefore, the subsidy is capital, would not be justified. ***The specific provision for capital subsidy in the main scheme and the lack of such a subsidy in the supplementary scheme (of 1991) meant that the recipient, i.e., the assessee had the flexibility of using it for any purpose. Unlike in Ponni Sugars (supra), the absence of any condition towards capital utilization meant that the policy makers envisioned greater profitability as an incentive for investors to expand units, for rapid industrialization of the State, ensuring greater employment. Clearly, the subsidy was revenue in nature.***

27. In view of the above discussion, the common question of law, is answered in favour of revenue and against the assessees in both cases."

Therefore, the Delhi High Court held that the said subsidy in the form of exemption from sale tax was revenue in nature.

Admitting the appeal of the assessee company, the Supreme Court stayed the operation of the order of the Delhi High Court.

High Court's approach of dismissing the Dept.'s appeal only because the Tribunal relied on Narang Overseas 111 ITD 1 (Mum.) (SB) which was on appeal had been dismissed for non-removal of defects is not correct. The High Court was directed to decide the question on merits.

Civil Appeal No. 19944/2017
[@ SLP (C) No. 6404/2017, dated 29th November, 2017] – CIT, Mumbai vs. Goodwill Theatres Pvt. Ltd .
THROUGH ITS MANAGING DIRECTOR

The 5-Member Special Bench in *Narang Overseas vs. ACIT (ITAT Mumbai 5 Member Special Bench) (2008) 111 ITD 1 (Mum) (SB)* laid down important principles of law regarding the taxability of *mesne* profits. The Special Bench overruled the *3-Member Special Bench in Sushil Kumar 88 ITD 35 (Kol.) (SB).*

The Department filed an appeal in the High Court against the order of the Special Bench. The High Court dismissed the appeal for non-removal of objections.

In the present case, the High Court dismissed the appeal of the Department on the ground that the Tribunal had merely followed *Narang Overseas vs. ACIT (supra).*

On appeal by the Department to the Supreme Court held reversing the decision of the High Court as under:

> *"Heard learned counsel for the parties and perused the impugned judgment and order dated 6-6-2016 passed by the High Court of Judicature at Bombay in Income Tax Appeal No.2356 of 2013 whereby the High Court has dismissed the appeal preferred by the appellant herein only on the ground that the decision relied upon by the Tribunal i.e., in the case of Narang Overseas Pvt. Ltd. vs. ACIT, Mumbai – (2008) 111 ITD 1 (Mum) (SB)], the appeal was preferred before the High Court and for non-removal of the defects the appeal has been dismissed.*
>
> *We are of the considered opinion that this was not a correct approach of the High Court for the simple reason that **merely because one authority has followed its own decision in another case and that matter in appeal has been dismissed on technical grounds still the High Court has to decide the question on merits**.*
>
> *Therefore, we set aside the impugned judgment and order passed by the High Court and remand the matter back to the High Court for deciding the same on merits expeditiously and in accordance with law."*

Low Tax Effect Circular: The view of the two-Judge Bench in Suman Dhamija & Gemini Distilleries that CBDT's low tax Circular dated 9-2-2011 cannot be given retrospective effect cannot be followed as it is contrary to the three-Judge Bench verdict in Surya Herbal. A beneficial circular has to be applied retrospectively while an oppressive circular has to be applied prospectively. Circular dated 9-2-2011 has retrospective operation except for two caveats: (i) The Circular should not be applied *ipso facto* when the matter has cascading effect and/or (ii) Where common principles are involved in subsequent group of matters or a large number of matters.

DIT, Circle 26(1), New Delhi vs. S.R.M.B. Dairy Farming (P) Ltd. – Civil Appeal Nos. 19650 of 2017 (Arising out of SLP(C) No. 24055 of 2017, dated 23rd November, 2017)

1. The Apex Court in its decision highlighted the propensity of Government Departments and public authorities to keep litigating through different tiers of judicial scrutiny which has led to increased litigation. It further observed that the Income Tax Department of the Government of India is one of the major litigants.

2. Keeping in mind the rising litigation in the country, the Union of India has framed 'the National Litigation Policy' to bring down the pendency of cases and get meaningful issues decided from the judicial forums rather than multiple tiers of scrutiny just for the sake of it. The Apex Court considered the National Litigation Policy Document and also relied on the objectives and policies mentioned therein.

3. In the present proceedings the Supreme Court was concerned with the implementation of Instruction No.3 of 2011 dated 9-2-2011 which provided that appeals not to be filed before the High Court(s) where the tax impact was less than ₹ 10 lakh. The said instruction also contained certain other conditions. The said Instruction was in supersession of the earlier Instruction No.1979 of 2000 dated 27-3-2000 where the limit of the tax effect was ₹ 4 lakh. The Instruction/Circular in question stated to have a prospective effect as per the Revenue and, thus, cases which were pending in the High Court(s) and had been filed prior to the Instruction in question (Instruction No. 3) but had tax effect of less than ₹ 10 lakh were, thus, required to be determined on their merits and not be dismissed by applying the circular/instruction.

4. It was observed that there had been a divergence of legal opinion on this aspect amongst the High Courts.

A) Following decisions held that the Circular had to be made applicable retrospectively,

- Karnataka High Court in the case of *Commissioner of Income Tax, Bangalore vs. Ranka & Ranka [(2013) 352 ITR 121 (Kar.)].*
- Bombay High Court in cases:
  - *Commissioner of Income Tax vs. Pithwa Engg. Works [(2005) 276 ITR 519 (Bom.)].*
  - *Commissioner of Income Tax vs. Madhukar K. Inamdar (HUF) [(2009) 318 ITR 149 (Bom.)].*
- Madhya Pradesh High Court & Delhi High Court in *Commissioner of Income Tax vs. Ashok Kumar Manibhai Patel & Co. [(2009) 317 ITR 386 (MP)* and *Commissioner of Income Tax vs. P.S. Jain & Co. [(2011) 335 ITR 591 (Delhi)].*

B) Following decisions of the High Courts were of the view that the Circular in question would apply only prospectively

- Punjab & Haryana High Court in *Commissioner of Income Tax vs. Varindera Construction Co. [(2011) 331 ITR 449 (P&H)].*
- Chhattisgarh High Court; Madras High Court & Kerala High Court in cases of *Commissioner of Income Tax vs. Navbharat Explosives Co. P. Ltd. [(2011) 337 ITR 515 (Chhattisgarh)]; Commissioner of Income Tax vs. Kodanand Tea Estates Co. [(2005) 275 ITR 244 (Mad.)]* and *CWT vs. John L. Chackola [(2011) 337 ITR 385 (Kerala)].*

C) After considering the aforesaid decisions of the various High Courts of India, the Hon'ble Supreme Court held as under:

"18. The view adopted by the Delhi High Court making the Circular applicable to pending matters came up before a three Judge Bench of this Court in *CIT vs. Surya Herbal Ltd.* [2013] 350 ITR 300/[2011] 202 Taxman 462/14 taxmann.com 142 (SC) when the following order was passed on 29-8-2011:

"Delay condoned.

Liberty is given to the Department to move the High Court pointing out that the Circular dated 9th February, 2011, should not be applied *ipso facto*, particularly, when the matter has a cascading effect. There are cases under the Income-tax Act, 1961, in which a common principle may be involved in subsequent group of matters or large number of matters. In our view, in such cases if attention of the High Court is drawn, the High Court will not apply the circular *ipso facto*. For that purpose, liberty is granted to the Department to move the High Court in two weeks. The Special Leave Petition is, accordingly, disposed of."

"19. The aforesaid order, in our view, actually should have laid the controversy to rest. The retrospective applicability of the Circular dated 9-2-2011 was not interfered with, but with two caveats – (i) Circular should not be applied by the High Courts *ipso facto* when the matter had a cascading effect; (ii) where common principles may be involved in subsequent group of matters or a large number of matters. It was opined that in such cases, the attention of the High Court would be drawn and the Department was even given liberty to move the High Court in two weeks. In our view this order holds the field and should continue to hold the field.

"20. Unfortunately, this order was not brought to the notice of the subsequent two Judge Bench of this Court in *CIT vs. Suman Dhamija* *[2015] 60 taxmann.com 460 (SC)*, again arising from a Delhi High Court order, wherein it was simply stated that since the appeals were preferred before 2011 and the instructions were dated 9-2-2011, the earlier cases would not be covered by the instruction. This order in turn had been followed by another two Judges Bench in *CIT vs. Gemini Distilleries* *[2017] 87 taxmann.com 112 (SC)*.

"21. Once again, in another matter *CIT vs. Century Park* *[2015] 373 ITR 32/63 taxmann.com 17/[2016] 236 Taxman 5 (SC)*, the line adopted by the three Judge Bench in ***Surya Herbal Ltd.*** case (*supra*) has been followed.

"22. We have already given our imprimatur to the observations made by the Karnataka High Court in a detailed analysis in ***Ranka & Ranka*** case (supra), which has dealt with the litigation policy philosophy behind applying the Circular and the benefit being extended in view thereof to all assessees where appeals have been pending, but below the financial limit, as otherwise an anomalous situation would arise.

"23. We may also take note of the judgment of this Court in *Suchitra Components Ltd. vs. CCE* *2007 taxmann.com 1555 (SC)* on the general principle of application of Circulars. Reliance was placed on the view expressed in *CCE vs. Mysore Electricals Industries Ltd.* *[2008] 12 STT 25 (SC)* opining that a beneficial circular has to be applied retrospectively while an oppressive circular has to be applied prospectively.

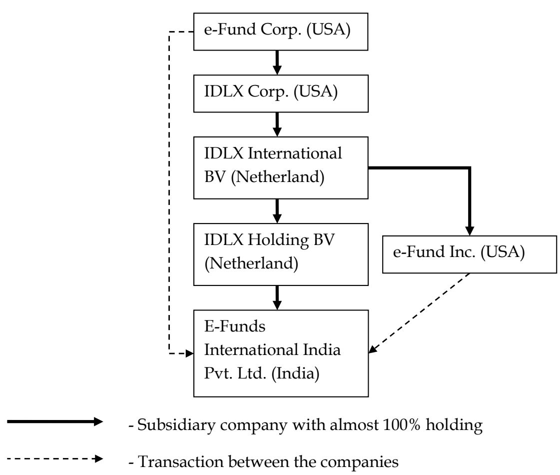
"24. We are of the view that the matter needs to be put to rest and a clarity be obtained in view of the impact of this issue on pending cases before the High Courts as well as the cases which have been disposed of by various High Courts by applying the Circular of 2011 to pending litigations. In our view the matter has been squarely put to rest taking further care of the interest of the Revenue by the order passed by the three Judge Bench of this Court in ***Surya Herbal Ltd.*** case (supra), which had put two caveats even to the retrospective application of the Circular. The subsequent orders have been passed by the two Judge Bench without those orders being brought to the notice of the Court, a duty which was cast on the Department to have done so to avoid the ambiguity which has arisen. Thus, the said view of the three Judge Bench would hold water and the Circular would apply even to pending matters but subject to the two caveats provided in ***Surya Herbal Ltd.*** case (supra).

"25. The appeals of the Revenue are, thus, dismissed in the aforesaid terms."

Permanent Establishment (PE) under Article 5 of DTAA: Entire law on concept of "fixed place of business", "service PE" and "agency PE" explained. The fact that there is close association and dependence between the US company and the Indian companies is irrelevant. The functions performed, assets used and risk assumed, is not a proper and appropriate test to determine whether there is a location PE

ADIT-I, New Delhi vs. M/s. E-Funds IT Solution Inc. Civil Appeal No. 6082 of 2015 dated 24th October, 2017

In this case, the assessees were foreign companies. The holding pattern of the assessee companies is pictorially depicted as under:



[In the diagram above, bold arrows display relations between the holding and subsidiary companies (in all cases holding is almost 100%) and dotted lines display the parties to the transaction under consideration]

Both e-Fund IT Solutions Group Incorporation ('e-Fund Inc.') and e-Fund Corporation had entered into international transactions with e-Fund International India Private Limited ('e-Fund India'). The assessing authority decided that the assessees, namely e-Fund Inc. and e-Fund Corp., had permanent establishment ('PE') in India as they had a fixed place where they carried on their own business in India and consequently were liable to pay tax for income generated by fixed place PE under Article 5 of the India-USA Double Taxation Avoidance Agreement ('DTAA').

CIT(A) held that not only because the assessees have fixed place PE but also they were service PEs and agency PEs and Article 5 of the Indo-USA DTAA would stand attracted.

In the appeal, the ITAT held that the order of the CIT(A) to be correct in holding that 'fixed place PE' and 'service PE' under article 5 of the DTAA would stand attracted while remaining silent on the issue of 'agency PE' as the same was not argued by the Revenue. ITAT while computing income of the assessees, by using a calculation formula different from that of CIT(A), arrived at nil figure of income for all the assessment years.

The assessees preferred an appeal before the High Court and the HC set aside the findings of all the authorities below and further dismissed cross-appeals of the Revenue.

Aggrieved by the decision of the High Court, the Revenue was before the Hon'ble Supreme Court.

The SC considered the following material during the course of the hearing:

- Section 90 of the Income-tax Act, 1961
- Article 5 of Indo-USA DTAA dealing with 'Permanent Establishment'
- Article 7 of Indo-USA DTAA pertaining to 'Business profits'
- Article 27 of Indo-USA DTAA pertaining to 'Mutual agreement procedure'
- Rule 44H of the Income Tax Rules, 1962
- Decision of the SC in case of *Formula One World Championship Ltd. vs. Commissioner of*

Income Tax, International Taxation-3, Delhi and Others [(2017) SCC Online SC 474]

- *DIT vs. Morgan Stanley [(2007) 7 SCC 1/284 ITR 260]*
- Report of the Deloitte Haskins and Sells dated 13th March, 2009 pertaining to the nature of business of the companies.

The SC in its considered opinion held as under:

*"12. Thus, it is clear that there must exist a fixed place of business in India, **which is at the disposal** of the US companies, through which they carry on their own business. There is, in fact, no specific finding in the Assessment Order or the appellate orders that applying the aforesaid tests, any fixed place of business has been put at the disposal of these companies. The assessing officer, CIT (Appeals) and the ITAT have essentially adopted a fundamentally erroneous approach in saying that they were contracting with a 100% subsidiary and were outsourcing business to such subsidiary, which resulted in the creation of a PE."*

The SC upheld the decision of the High Court. The High Court in its order had held as under:

"49. The Assessing Officer, Commissioner (Appeals) and the Tribunal have primarily relied upon the close association between e-Fund India and the two assessees and applied functions performed, assets used and risk assumed, criteria to determine whether or not the assessee has fixed place of business. This is not a proper and appropriate test to determine location PE. The fixed place of business PE test is different. Therefore, the fact that e-Fund India provides various services to the assessee and was dependent for its earning upon the two assessees is not the relevant test to determine and decide location PE. The allegation that e-Fund India did not bear sufficient risk is irrelevant when deciding whether location PE exists. The fact that e-Fund India was reimbursed the cost of the call centre operations plus 16% basis or the basis of margin fixation was not known, is not relevant for determining location or fixed place PE. Similarly what were the direct or indirect costs and corporate allocations in software development centre or BPO does not help or determine location PE. Assignment or sub-contract to e-Fund India is not a factor or rule which is to be applied to determine applicability of Article 5(1). Further whether or not any provisions for intangible software was made or had been supplied free of cost is not the relevant criteria/test. e-Fund India was/is a separate entity and was/is entitled to provide services to the assessees who were/are independent separate taxpayers. Indian entity i.e. subsidiary company will not become location PE under Article 5(1) merely because there is interaction or cross transactions between the Indian subsidiary and the foreign Principal under Article 5(1). Even if the foreign entities have saved and reduced their expenditure by transferring business or back office operations to the Indian subsidiary, it would not by itself create a fixed place or location PE. The manner and mode of the payment of royalty or associated transactions is not a test which can be applied to determine, whether fixed place PE exists."

The Supreme Court in its observation remarked about the High Court's order as under:

"13. It further went on to hold that the ITAT's finding that the assessees were a joint venture or sort of partnership with the Indian subsidiary was wholly incorrect. Also, none of these arguments have been invoked by the Revenue and such a finding would, therefore, be perverse. After citing Klaus Vogel on Double Taxation Conventions, Arvid A. Skaar in Permanent Establishment: Erosion of a Tax Treaty Principle and Bollinger vs. Commissioner, 108 S.Ct. 1173, the High Court found against the Revenue, holding that there is no fixed place PE on the facts of the present case. We agree with the findings of the High Court in this regard."

The SC further considered the report of the Deloitte Haskins and Sells dated 13-3-2009 and held:

"16. This report would show that no part of the main business and revenue earning activity of the two American companies is carried on through a fixed business place in India which has been put at their disposal. It is clear from the above that the Indian company only renders support services which enable

the assessees in turn to render services to their clients abroad. <u>This outsourcing of work to India would not give rise to a fixed place PE and the High Court judgment is, therefore, correct on this score.</u>"

While dealing with the issue of 'service PE', the SC considering the judgment of *DIT vs. Morgan Stanley* (supra) held that:

"18. It has already been seen that none of the customers of the assessees are located in India or have received any services in India. This being the case, <u>it is clear that the very first ingredient contained in Article 5(2)(l) is not satisfied</u>. However, the learned Attorney General, relying upon paragraph 42.31 of the OECD Commentary, has argued that services have to be furnished within India, which does not mean that they have to be furnished to customers in India. Para 42.31 of the OECD Commentary reads as under: "Whether or not the relevant services are furnished to a resident of a state does not matter: what matters is that the services are performed in the State through an individual present in that State."

Based upon the said paragraph 42.31 of the OECD Commentary, the counsel for the Revenue argued that, in assessment year 2005-06, two employees of the American firm were seconded in India and that, therefore, it was clear that management of the American company through theses employees had obviously taken place. The SC observed that while dealing with this issue, the High Court had found as follows:

"62. The appellants had pleaded before the authorities and the Tribunal that prior to assessment year 2005-06 not even a single employee of the assessee ever visited India even for a short period and in 2005-06, two employees of e-Fund were transferred to e-Fund India and that the entire expenditure for these two employees were borne by e-Fund India. No employees were present in India after 2005-06. Presence of employees in India is relevant under Article 5(2)(l) but the said employees should furnish services within the contracting State. These services should not be mere stewardship services. The Assessing Officer has recorded that employees were seconded to e-Fund India but the functions they performed and whether they performed functions and reported to e-Fund Corp/associated enterprise was not known or ascertained. This was not the correct way of determining and deciding whether service PE existed. Whether the seconded employees were performing stewardship services or were directly involved with the working operations was relevant. It is also not known whether the services were performed related to services provided to an associated enterprise in which case clause 5(2)(l)(ii) would be applicable. In the said situation, the question of attribution of income etc. would also arise."

"63. Two employees of e-Fund Corp were deputed to e-Fund India in the assessment years 2005-06. The case of the assessee and e-Fund India is that they were deputed to look towards development of domestic work in India. Payment of these employees as per the Revenue to the extent of 25% was borne by e-Fund India and balance 75% was borne by e-Fund Corp. The Assessing Officer on this basis has observed that this reduced cost base of e-Fund India as remuneration was paid by e-Fund Corp and the said employees were at liberty to perform functions of e-Fund Corp even while working for e-Fund India. The response of the assessee as quoted in the assessment order was that e-Fund India, apart from export activities had also domestic business in India. This was evident from the return of income filed by e-Fund India where domestic income was computed separately as it was not eligible for deduction under Section 10A of the Act. Copy of the return was furnished. It was further stated that cost of personnel seconded in India was fully borne by e-Fund India i.e. 100% of the salary paid to the said employees seconded to India were debited to profit and loss accounts. 75% of the salary component was paid abroad by e-Fund Corp but the same was reimbursed by e-Fund India. This was in accordance with and permitted under the Indian Exchange Control Regulations. It was further stated that the Assessing Officer was wrong in assuming that the two seconded employees were at liberty to function for e-Fund Corp while they were working for e-Fund India. The seconded employees were working under the control and supervision of e-Fund India. The Assessing Officer thereupon has not commented on the reply

of the assessee, though he has recorded comments in respect of replies to other issues raised by him (see paragraph 7 of the assessment order). The aforesaid factual assertion made by the assessee, therefore, was not negated or questioned by the Assessing Officer."

The SC further held:

"20. We entirely agree with the approach of the High Court in this regard. Article 42.31 of the OECD Commentary does not mean that services need not be rendered by the foreign assessees in India. If any customer is rendered a service in India, whether resident in India or outside India, a "service PE" would be established in India. As has been noticed by us hereinabove, no customer, resident or otherwise, receives any service in India from the assessees. All its customers receive services only in locations outside India. Only auxiliary operations that facilitate such services are carried out in India. This being so, it is not necessary to advert to the other ground namely, that "other personnel" would cover personnel employed by the Indian company as well, and that the US companies through such personnel are furnishing services in India. <u>This being the case, it is clear that as the very first part of Article 5(2)(l) is not attracted, the question of going to any other part of the said Article does not arise</u>. It is perhaps for this reason that the Assessing Officer did not give any finding on this score."

On the issue of the 'agency PE' the SC held:

"21. Shri Ganesh has argued before us that the "agency PE" aspect of the case need not be gone into as it was given up before the ITAT. He is right in this submission as not argument on this score is found before the ITAT. However, for the sake of completeness, it is only necessary to agree with the High Court, that it has never been the case of Revenue that e-Funds India was authorized to or exercised any authority to conclude contracts on behalf of the US company, nor was any factual foundation laid to attract any of the said clauses contained in Article 5(4) of the DTAA. This aspect of the case, therefore, need not detain us any further."

Considering the decision of Morgan Stanley (supra) the Apex Court further held:

"22. Shri Ganesh is correct in stating that as the arm's length principles has been satisfied in the present case, no further profit would be attributable even if there exists a PE in India."

During the course of the hearing, with regard to the arguments in relation to MAP settlement, the SC considered the available material, namely, i) Resolution dated 23-4-2007 passed by the competent authority of India, ii) paragraph 3.6 of the OECD Manual on MAP procedure and iii) OECD Manual on best practices. Keeping in view the above material, the SC held:

"27. A perusal of the above would show that a competent authority should engage in discussion with the other competent authority in a principled, fair and objective manner, with each case being decided on its own merits. It is also specifically observed that where an agreement is not otherwise achievable, then both parties should look for appropriate opportunities for compromise in order to eliminate double taxation on the facts of the case, even though a principled approach is important. The learned Attorney General also relied upon Best Practice No. 1 of the said OECD Manual, which requires the publication of mutual agreements reached that may apply to a general category of taxpayers which would then improve guidance for the future. Best Practice No.1 has no application on the facts of the present case, as the agreement reached applies only to the respondent companies, and not to any general category of taxpayers. <u>It is clear, therefore, that Shri Ganesh is right in relying upon Article 3.6 of the OECD Manual. It is very clear, therefore, that such agreement cannot be considered as a precedent for subsequent years, and the High Court's conclusion on this aspect is also correct.</u>"

Accordingly, the SC concluded that MAP agreement could not be considered as a precedent as the same was applicable only to assessees and not to any general category of taxpayers.



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Advocates

DIRECT TAXES
High Court

1. Charitable purpose – Section 2(15) of Income Tax Act, 1961 – denial of exemption on the ground that the assessee is charging fees for rendering services from members or non-members unjustified. A.Ys. 2010-11, 2011-12

CIT (E) vs. Fertilizers Association of India [2017] 399 ITR 209 (Delhi)

The assessee was a non-profit and non-trading company registered under section 25 of Companies Act, 1956. It represented interests of fertilizer manufacturers, distributors, importers, equipment manufacturers, research institutes and suppliers of inputs. The AO observed that the assessee has collected fee from its members as well as non-members for conducting seminars/workshops and hence he disallowed the exemption claimed under section 2(15) of the Act. The department being aggrieved by the order of the Appellate Tribunal preferred an appeal before the Hon'ble Delhi High Court. The Hon'ble court dismissed the appeal of the revenue by observing that Tribunal rightly held that the charging of fee from members or non-members for rendering services like training, conducting seminars would not *ipso facto* lead to denial of exemption. The dominant object of the assessee remains charitable and the aforesaid activities are only incidental to the main activity of the assessee.

2. Power of Commissioner of Income Tax (Appeals) – Section 251 of the Income Tax Act, 1961 – Commissioner (Appeals) can enhance an assessment but not assess a new source of income. A.Y. 1995-96

CIT vs. B.P. Sherafudin [2017] 399 ITR 524 (Ker.)

For the A.Y. 1995-96, the assessee, an individual, filed his return declaring total income at ₹ 13,840/-. The A.O. after considering the relevant details and explanations passed the assessment order determining total income of the assessee at ₹ 7,80,160/-. On appeal, the First Appellate Authority enhanced the income of the assessee by ₹ 22,15,116/- taking note of unexplained income in the statement of receipts and payments submitted by the assessee which escaped the attention of the A.O. The Appellate Tribunal deleted the addition observing that the addition of new income of ₹ 22,15,116/- was not before the A.O. and was not subject-matter of assessment.

The department being aggrieved by the impugned order approached the Hon'ble Kerala High Court under section 260A of the Act.

Hon'ble court observed that the First Appellate Authority is invested with very wide powers under section 251(1)(a) of the Act and once an assessment order is brought before the authority, his competence is not restricted to examining only those aspects of the assessment about which the assessee makes a grievance and ranges over the whole assessment to correct the Assessing Officer not only regarding a matter raised by the assessee in appeal but also regarding any other matter considered by the Assessing Officer and determined in assessment. It is not open to the Appellate Commissioner to introduce in the assessment a new source of income and the assessment must be confined to those items of income which were the subject-matter of the original assessment. The Court held that undeniably, the precedential position on the powers of the First Appellate Authority under section 251 undulates. There are seeming contradictions. But, as held by *Union Tyres [1999] 240 ITR 556 (Delhi)*, and as affirmed on reference by *Sardari Lal [2001] 251 ITR 864 (Delhi) [FB]*, there is a consistent judicial assertion that the powers under section 251 are, indeed, very wide; but, wide as they are, they do not go to the extent of displacing powers under, say, sections 147, 148, and 263 of the Act.

3. Cash credits – section 68 of the Income Tax Act, 1961 – Onus of proof – Source of source – A.Y. 1995-96

CIT vs. B.P. Sherafudin [2017] 399 ITR 524 (Ker.)

For the assessment year 1995-96, the assessee, an individual, filed a revised return declaring a total income of ₹ 38,030. The savings bank account of the assessee's wife had two deposits of ₹ 5 lakhs each. Asked to explain the source of these deposits, the assessee, first, maintained that they were remitted from abroad. Later, he changed his stand and said that the amounts had been borrowed from non-resident friends. Once again, he changed his stand and asserted that, while coming back to India, he brought 12 bars of gold on October 26, 1992. He sold them to his relatives and realised ₹ 5 lakh which he deposited into his wife's bank account. He furnished the purchasers' names, too. Of the 12 purchasers, the Assessing Officer examined five but disbelieved their version. So he concluded that the source for ₹ 5 lakh remained unexplained. This was added to the income of the assessee. The High Court observed that the Evidence Act *per se* does not apply to the proceedings under the Income-tax Act, with its own provisions on the burden of proof. The Assessing Officer is a quasi-judicial authority not fettered by technical rules of evidence and pleadings; he is entitled to act on materials which may not be accepted as evidence in a court of law. However, it is equally clear that in making the assessment, the Income-tax Officer is not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all. There must be something more than bare suspicion to support the assessment. The Income-tax Officer is entitled to satisfy himself on the true nature of cash credits and source of the amounts entered. If the entry stands not in the name of any such person having a close relation or connection with the assessee, but in the name of an independent party, the burden will, still lie upon the assessee to establish the identity of that party and to satisfy the Income-tax Officer that the entry is real and not fictitious. Once the identity of the third party is established before the Income-tax Officer, and *prima facie* evidence is placed before him asserting that the entry is not fictitious, the burden of proof initially lying on the assessee can be said to have been duly discharged by him. It will not, therefore, be for the assessee to explain further on how or under what circumstances the third party obtained the money, and how or why he advanced the money as a loan to the assessee. If the assessee has adduced evidence to establish *prima facie* the source of cash credit, the onus shifts to the Department. At the same time, the assessee must produce cogent evidence to rebut the presumption; a bald explanation is not enough. The mere furnishing of or the mere fact of payment by an account payee cheque, or mere identification of donor or creditor, or the mere submission of the confirmatory letter by the creditor is by itself not enough to shift the onus on to the Department, although these facts may, along with other facts, be relevant in establishing the genuineness of the transaction. The Court observed that the assessee changed version three times about the source of ₹ 5,00,000. The Assessing Officer examined five witnesses; none inspired confidence or sounded even remotely truthful. True that the assessee provided the particulars of the other alleged purchasers, too. Equally true is the fact that the principle of *falsus uno, falsus omnibus* does not apply to the testimonies in the courts of India. Those unsummoned witnesses may have thrown more light on the issue, and the falsity of the witnesses already examined could have posed no hurdle. But, at the same time, the diligent efforts by the Assessing Officer to get at the truth cannot be discounted. The High Court thus confimed the addition holding that by changing his versions frequently and by producing witnesses who inspired no confidence, the assessee did not discharge his primary burden. Absent that discharge, it cannot be insisted that the Assessing Officer could have probed further and further.

4. Cash credits – Section 68 of the Income-tax Act, 1961 – Share application money – identity of investors disclosed – Amount received through banking channel – Initial burden discharged – Addition cannot be sustained. A.Y. 2007-08

Lalitha Jewellery Mart Pvt. Ltd. vs. DCIT [2017] 399 ITR 425 (Mad.)

The assessee a private limited company engaged in the business of manufacturing and trading in gold/jewellery. It raised share capital to the tune of ₹ 21.96 crore. During the course of assessment proceedings, the assessee submitted proof and identity of the investors and the fact that the payment was received through banking channel. The A.O., however, finalized the assessment by adding the said amount under section 68. The Assessing Officer has held that though monies were routed through banking channels, the explanation offered by the assessee-company was not acceptable, as the said explanation was not convincing and satisfactory. The Assessing Officer noticed that one Sri Shahul Hameed initially purchased gold through one of his firms and later on, sold the gold again to the assessee-company and thereafter, the sale proceeds were paid over for acquiring the shares. The AO alleged that this sort of cycling and re-cycling of funds does not carry any conviction and hence, the share capital was treated as "income" in the hands of the assessee. The CIT(A) partly allowed the appeal. The Tribunal reversed the decision of the Learned CIT(A) by observing that by resorting to such cyclical method the assessee had entered into "make believe management practices" rather than genuine transactions. On further appeal the High Court observed that the main theme, upon which, the Assessing Officer as well as the Tribunal proceeded to discredit the investors of the assessee is completely erroneous. They were both looking for proof beyond doubt. They were proceeding on an element of suspicion that the amounts of investments are really those of the assessee, which have been ploughed back by the assessee, whereas the settled principle of law is that any amount of suspicion, however strong it might be as well, is no substitute for proof. Suspicion is not sufficient enough to lead to a conclusion that the investments received by the assessee-company are all manipulated receipts and on that basis, recorded a finding that the explanation of the assessee is not satisfactory.

So long as the proof and identity of the investor and the payment received from him is through a doubtless channel like that of a banking channel, the receipt in the hands of the assessee towards share capital or share premium does not change its colour. The money so invested in the assessee-company would still be the money available and belonging to the investors. The consistent principle followed is that the investors' sources and creditworthiness cannot be explained by the assessee. If the Department has a doubt about the genuineness of the investors capacity, it is open to it to proceed against those investors. Without taking such a course of action, the Assessing Officer and the Tribunal are proceeding on conjectures that the assessee has, in fact, ploughed back the money. The very approach of the Assessing Officer and the Tribunal are completely opposed to settled legal principles enunciated and they have arrived at conclusions contrary to the legal principles on the subject. Further, they are finding fault with the assessee for the alleged failure of its investors in proving beyond doubt that they have the capacity to invest at the moment they did in the assessee-company. That is clearly a perverse view, as the Assessee is not expected to perform a near impossibility. The assessee cannot call upon its investors to disclose all such business transactions they carried on in the immediate past and as to how much they made from their respective business enterprises. The assessee cannot also call upon its investors to prove their good business sense in investing in the assessee-company, as such investors cannot gain any controlling stake. Addition made was thus deleted.

5. Section 2(22)(e) – Not applicable if no actual payment – Even if cheque is issued and the amount is reflected in accounts as payable

CIT vs. Associated Metals Co. Ltd. – [Income Tax Appeal 532 of 2011 Allahabad High Court]

For Assessment Year 1995-96 the assessee disclosed a credit balance of ₹ 3,75,26,099/- standing in the name of a sister concern of the assessee, Goel Investments Ltd. (GIL). During the assessment proceedings, the Assessing Officer proposed to tax the said amount treating the same to be deemed dividend under Section 2(22)(e) of the Act. The assessee objected to the said proposal and it submitted that it had shown credit balance of ₹ 3,76,26,009/- of GIL on account of a cheque having been issued by GIL to Vasulinga Sugar & General Mill Ltd. ("Vasulinga" for short). That cheque had not been accepted by said Vasulinga and returned back to GIL. However, the reversal/rectification entries were made in the next financial year and, therefore, the entries did not represent any real transaction of payment of money. It was only an accounting entry. The AO however added the said credit balance as deemed dividend u/s. 2(22)(e). On appeal the same was reversed by CIT (A) and which was confirmed by the Tribunal holding that since the cheque issued by GIL was never encashed / presented for payment by Vasulinga, no actual payment was made so as to attract section 2(22)(e) of the Act. The Hon'ble High Court confirmed the order of the Tribunal holding that mere issuance of a cheque that was subsequently cancelled and returned without ever being ever presented for encashment and without any money having been paid against the same to the assessee it could never constitute payment of any sum. Notwithstanding the fact the cheque was subsequently cancelled and returned, the provision of Section 2(22)(e) never got attracted to the facts of the case for a simple reason that no amount of money was ever received by the assessee. To apply a notional provision of the statute the revenue should have shown to exist actual fact of payment and it could not have inferred notional or deemed dividend on a notional payment in absence of express intention to that effect expressed by the legislature. In absence of satisfaction of statutory precondition of "payment" of "any sum", to the assessee the provision of Section 2(22)(e) was never attracted.

Note: The facts stated in this judgement are silent as to the other aspect i.e. whether the transaction was the one otherwise attracting S.2(22)(e) being in the nature of one with a shareholder.

Bombay high Court in case *CIT vs. Triumph International Finance (I) Ltd. (2012) 345 ITR 270*

(Bom.) has upheld penalty u/s. 271E on the ground that repayment of loan/deposit by merely debiting account through journal entries, is in contravention of section 269T.

6. Income from share transactions – Capital Gains or business income – Duty of the Tribunal to look into entire facts

Jaya Chheda L/H Late Hitesh S. Bhagat vs. ACIT – (ITXA Nos. 325 and 326 of 2015, Bombay High Court)

For A.Y. 2007-08 the assessee had claimed income of ₹ 3.44 crore from transactions in shares as Capital Gains. The AO treated the entire gains as Business Income on the ground that the assessee had transacted in 41 scrips and out of the total 86 transactions carried out by him in 42 transactions the holding period of shares ranged from 0 days to 42 days apart from making adverse observations on volume and frequency and repetitive transactions in same scrips. Interestingly for A.Y. 2008-09, the same AO who framed the assessment for A.Y. 2007-08, held in the assessment order for A.Y. 2008-09 that an amount of ₹ 25,88,046/represents the profit on purchase and sale of shares within a span of 30 days. Therefore, he held that the said income will have to be treated as business income of the assessee. However, as the claim of the assessee as regards STGC in the Assessment Year 2007-08 was not accepted, even the balance amount of ₹ 1,08,74,670/- was ordered to be treated as business income. Against these orders the assessee filed an appeal before the CIT(A). The CIT(A) reversed the order of the AO for A.Y. 2007-08 holding the said gains as Capital Gains. For AY 2008-09 he held that the gains for a period of more than 30 days amounting to ₹ 1.08 crore be treated as capital gains and the balance arising from holding shares for less than 30 days be treated as Business Income. On a further appeal before the Tribunal by the Department for A.Y. 2007-08, the order of CIT (A) got reversed. For A.Y. 2008-09 the Tribunal dismissed the Appeal filed by the assessee. On a further appeal by the assessee, the Hon'ble High Court held that the Appellate Tribunal has rejected the claim that it was STCG, by referring to only 42 transactions out of 86, in respect of rest of the 44 transactions, without any examination of details and factual aspects. There was no reason to treat other 44 transactions on par with 42 transactions in respect of which holding was only for 7 days. Since the entire data of each transaction was before the Appellate Tribunal nothing prevented it from looking into all the transactions and recording findings of fact. But the Appellate Tribunal has not done its duty and therefore, the finding recorded by the Appellate Tribunal in relation to the Assessment Year 2007-08 will have to be held as perverse. As far as the assessee's appeal for A.Y. 2008-09, substantial part of claim of STCG was accepted by the CIT(A). The Appellate Tribunal held that 30 days holding period could not have been taken as a fixed criteria for determining the nature of transaction and further observed that the nature of transaction has to be determined after taking into consideration various factors. The Appellate Tribunal held that the holding period is one of the several factors which is required to be taken into consideration. Thus even after finding that the formula adopted by the CIT(A) based on holding period of 30 days was erroneous, the Appellate Tribunal has not gone into the details of all the transactions. The Hon'ble High Court held that, after accepting that the formula of 30 days adopted by the CIT(A) was erroneous, the Appellate Tribunal ought to have considered the appeal on merits. It was further held that that the entire approach of the Appellate Tribunal while dealing with the cases for both the years was completely erroneous. The Appellate Tribunal had failed to perform its duty and therefore, the impugned judgment and order of the Appellate Tribunal cannot be sustained at all. The case was remanded to the Appellate Tribunal for deciding afresh in accordance with law.



Neelam Jadhav, Keerthiga Sharma &
Neha Paranjpe, *Advocates*

DIGEST OF CASE LAWS
Tribunal

Reported Decisions

Section 5 – Article 12 of India-UK DTAA – Guarantee fee income is taxable in India since it accrues in India. It is not interest income as per Article 12, but will be taxed in India per domestic laws as per Article 23

Johnson Matthey Public Ltd. Company vs. DCIT [2017] 88 taxmann.com 127 (Delhi – Trib.) Assessment Year 2011-12

Facts

The assessee provided guarantees to support credit facilities extended to its subsidiaries in India by banks. In its return of income it treated the guarantee fees received from Indian subsidiaries to be in the nature of interest income under Article 12 of India-UK Double Taxation Avoidance Agreement ('DTAA') and offered it to tax @ 15%. It had also paid salary of a seconded employee on behalf of its associated enterprise, and since it was reimbursement in nature, it was not offered to tax. The Assessing Officer ('AO') treated the guarantee fees as other income under Article 23 of the India-UK DTAA and taxed it at the rate of 40% (plus surcharge and cess). Further, the AO also treated the disbursement of salary on behalf of AE as taxable Fee for Technical Services ('FTS') @ 15% in terms of Article 13 of India UK-DTAA.

Held

The Income Tax Appellate Tribunal ('ITAT' / 'Tribunal') admitted the additional ground that the fee earned for providing guarantee to foreign banks did not accrue or arise in India since the source was outside India. The Tribunal held that the guarantee income accrued in India since loan transaction took place in India. Though it was contended that the assessee had entered into the global corporate guarantee agreement with the banker outside India, the Tribunal observed that on that account alone no receipts would accrue to the assessee in the jurisdictions where the loan facility was not availed by the subsidiaries. It further observed that it was not the entering of the global corporate agreement outside India that occasioned the assessee to charge the guarantee commission, but it was the act of the subsidiary in availing the loan that accrued the guarantee commission to the assessee. Since the loan transaction took place in India, the guarantee fee income accrued in India.

The ITAT also held that the guarantee fee was not interest income as per Article 12(5) of the India-UK DTAA. The Tribunal held that the contract of loan was different from the contract of guarantee, and the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" did not include payment of guarantee commission received by the assessee in India. The assessee was a stranger to the privity of contract of loan between the Indian entity and the banker and hence the guarantee fee was not interest income and if this was considered as interest income then other payments like consultancy charges, expenditure incurred for the purpose of pre-loan documentation and the host of expenditure incurred with third parties and not relatable to the loan transaction proper, will have to be treated as "interest". Further, the ITAT also held that the assessee was not in the business of giving guarantees and hence the guarantee fee was not business income, and neither was it fees for technical services. The ITAT concluded that in view of Article 23(3) of the India-UK DTAA, in the absence of any specific provision dealing with corporate/ bank guarantee recharge, the same was to be taxed in India as per the provisions of the Income-tax Act, 1961 ('Act').

With regard to the reimbursement of salary of seconded employee, the ITAT set aside the issue to the AO and directed the assessee to file the secondment contract, secondment agreement, the employment contract and salary reimbursement agreement.

Article 29 – Benefit of India-UAE DTAA will be available if a company is incorporated in UAE, though its shareholders are German companies

ITO vs. Martrade Gulf Logistics FZCO-UAE [2017] 88 taxmann.com 102 (Rajkot – Trib.) Assessment Year: 2008-09

Facts

The Assessee Company was registered in UAE. Its directors were of different nationalities, other than from UAE, being Indian, German and Portuguese. The AO sought to deny the benefit of the India-UAE DTAA since as per Article 29, an entity which was a resident of a Contracting State shall not be entitled to the benefits of India-UAE Tax Treaty if the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits of India-UAE Tax Treaty which would not have been otherwise available to it and that the company should be considered as a resident of the country in which its place of effective management is situated, though its employees were situated in UAE. The AO also disregarded the tax residency certificate submitted by the assessee. On appeal, the Commissioner of Income-tax (Appeals) ('CIT(A)') ruled in favour of the Assessee after taking into consideration the tax residency certificate, trading licence, incorporation certificate and other documents. The Revenue filed an appeal before the ITAT.

Held

The ITAT held that since the company was incorporated in UAE, it was a resident of UAE and was hence eligible to take benefit of the India-UAE DTAA. The Tribunal held that conditions of Article 29 of the India-UAE DTAA were not satisfied to revoke the benefits of the said treaty. It also observed that whether the company was to be formed in UAE or in Germany, it would not have any material difference so far as non-taxability of said income in India was concerned. As corollary to this legal position, merely because the company was set up in UAE and not in the country to which the capital belonged to i.e., Germany, the assessee did not get any benefits of the India-UAE DTAA, which would have been otherwise available. The Tribunal also upheld the order of the CIT(A), which had held that the place of effective management of the assessee was UAE.

Capital gains – Section 45(4) – Provision of section 45(4) of the Act triggers only when there is dissolution of a Partnership firm

Mahul Construction Corporation vs. ITO [2017] 88 taxmann.com 181 (Mumbai – Trib.) Assessment Year: 2009-10

Facts

The assessee was a partnership firm, engaged in the business of construction and development. The assessee, *vide* an agreement, acquired development rights over a piece of land for a consideration. Subsequently, this partnership deed was modified and new partners were inducted. Further, *vide* retirement & reconstitution deed, three partners retired from the firm and took the amount credited to their accounts including surplus on account of revaluation of asset. During the course of assessment the AO observed that the assessee has not carried out any development work till 1-4-2008. Thus, the land acquired by the assessee was a capital asset and not a stock-in-trade. Accordingly, the AO invoked the provisions of section 45(4) of the Act and assessed the entire revaluation surplus of ₹ 67,69,60,000 as taxable in the hands of the assessee firm. On appeal, the CIT(A) confirmed the action of the AO. The assessee, being aggrieved by the order of the CIT(A), preferred an appeal before the Tribunal.

Held

The ITAT observed that the assessee firm or the continuing partners were not the beneficiaries as no new tangible income or asset had come to them, rather the Assessee firm and continuing partners had purchased the share of retiring partner by paying cash. It was the retiring partners, who have been benefitted by receiving much more than the actual capital contributed by them on account of revaluation. It was the retiring partners, who have transferred their rights in the property to the continuing partners. The mode of retirement revealed that it clearly envisaged an extinguishment and assignment of the retiring partners rights over the partnership and its properties in favour of the continuing partners and thereby the retiring partners were exigible to capital gains tax. It was clear from the retirement deed that the retiring partners merely retired from the partnership firm without any distribution of assets of the firm amongst the original and new incoming partner. Since the reconstituted firm consisted of 3 old partners and 1 new partner, it was not a case where firm with erstwhile partners was taken over by new partners only. That meant the assessee firm had acquired its right in the assets of the firm by paying lump sum consideration which was nothing but the cost of improvement within the meaning of section 48(ii) of the Act. It was not a case of distributing capital assets amongst the partners at the time of retirement and therefore provisions of section 45(4) were not applicable. While the firm was subsisting, there could not be any transfer of rights in the assets of the firm by any or all partners amongst themselves because during subsistence of partnership, the firm and partners did not exist separately. There could be no transfer to oneself. This could only happen when there was dissolution of the firm. Therefore, it was not a case of distributing capital assets amongst the partners at the time of retirement and therefore provisions of section 45(4) were not applicable.

Unreported Decisions

Section 292B – Assessment order in the name of a non-existent entity was null and void, though the name of the existing entity was also mentioned in the assessment order

Shell India Markets Private Limited vs. Addl. CIT (ITA Nos. 1055/Bang/2011, 772/Mum/2013 dtd.

December 20, 2017) Assessment Years: 2007-08 & 2008-09

Facts

The AO had passed the assessment order for AY 2008-09 on November 30, 2012 in the name of Shell Technology India Pvt. Ltd., though as on the date of assessment order, it had ceased to exist on account of its merger with M/s. Shell India Markets Pvt. Ltd. and the orders of the High Courts were communicated to the AO. The merger was approved by the High Courts of Karnataka and Madras *vide* orders dated February 22, 2010 and February 24, 2010 respectively. The orders were communicated to the AO on September 21, 2010.

However, for AY 2007-08, the assessment order was made in such a manner that the name of the assessee was mentioned as "M/s. Shell Technology India Pvt. Ltd. (now called as Shell India Markets Pvt. Ltd.)". The assessee contended that both the assessment orders were null and void.

Held

The ITAT held that the assessment order for AY 2008-09 was null and void since it was made in the name of a non-existent concern. It also held that the error was not a procedural defect as it went to the root of the jurisdiction of the AO. The Tribunal also quashed the order for AY 2007-08 and held that the manner in which the AO had described the assessee in the assessment order clearly pointed out that according to him, M/s. Shell Technology India Pvt. Ltd. continued to be in existence, and, thus it could not be understood that the assessment has been completed in the name of the new entity, i.e. M/s. Shell India Markets Pvt. Ltd. Further, the ITAT also observed that the fact that the assessee had filed its appeal as "M/s. Shell Technology India Pvt. Ltd. (now legally merged into Shell India Markets Pvt. Ltd.)" was only a technical defect and it was suo motu rectified by the assessee by filing a revised Form 36B and in fact, the entity which presented the appeal was actually Shell India Markets Pvt. Ltd. since its director had signed the memo of appeal.

Section 44BB – Amount of service tax being in nature of statutory payment could not be included in gross receipts for purpose of computing presumptive income u/s. 44BB

Swiwar Offshore Pte. Ltd. & Anr. vs. Addl. DIT (International Taxation) & Anr. (ITA Nos. 4994/Mum/2012, 3680/Mum/2015 dt. November 30, 2017)

Assessment Years: 2009-10 & 2010-11 dtd. 30-11-2017

Facts

During the assessment, the AO found that the assessee had charged service tax to customer as a part of the billing for the charter hire charges. The assessee contended that such service tax collected by the assessee was on behalf of the Government, that same had been paid to the Government account as and when the liability arose, that it acted as a trustee for the Government for the service tax collected and paid, that the same was not included in the gross receipts of the assessee for computing its income chargeable to tax. The AO held that that such service tax receipts would be a part of the gross receipts of the assessee chargeable to tax u/s. 44BB. The CIT(A) reversed the decision of the AO and directed to delete the said amount of service tax collection from the gross receipts while computing the profit chargeable to tax in terms of the provisions of section 44BB.

Held

The service tax collected by the assessee from the customer in nature of statutory payment could not be included in gross receipts for computing income under section 44BB of the Act.

Section 263: Revisionary proceedings u/s. 263 would be invalid when Assessment order was passed on non-existing entity

Reliance Capital Ltd. vs. Pr. CIT ITA No.3811/Mum/2017 dt. 21-12-2017 (Mum.)(Trib.) Assessment Year: 2012-13

Facts

The assessee was carrying on business through e-commerce, e-shopping, internet and other web application networks. The assessment was framed on Emerging Money Mall Ltd. (EMML) which had been merged with the Reliance Capital Ltd. (RCL) and thus the assessee i.e., EMML ceased to exist from April, 2013, the date when amalgamation /merger scheme became effective. In spite of the aforesaid fact the assessment was done in the name of EMML in March, 2015 which was on non-existent despite the fact being brought to the notice of AO.

The CIT issued show cause notice to the assessee as to why the assessment framed u/s. 143(3) in the name of EMML should not be set aside u/s. 263 as being erroneous and prejudicial to the interest of the revenue. As the AO passed the assessment order in the name of EMML which had ceased to exist with effect from April, 2013 and thus there had been total non-application of mind on the part of the AO.

Held:

The date when amalgamation/merger scheme became effective was before the completion of assessment and yet the assessment order was been passed in the name of EMML (formerly known as Reliance Money Mall Ltd.). The AO despite keeping on record the order of the Hon'ble Bombay High Court approving the scheme of amalgamation, failed to pass the assessment order in the name of Reliance Capital Ltd. (RCL) on behalf of Emerging Money Mall Ltd. (EMML) which merged with Reliance Capital Ltd. w.e.f. March, 2013. Further, the Pr. CIT himself was of the opinion that the assessment order issued in the name of EMML was not correct status, in spite of that issued notice on EMML. The Tribunal held that the assessment order passed in the name of EMML is bad-in-law. And consequently revisionary jurisdiction with respect to that order exercised by the PCIT u/s. 263 was also invalid.

Section 69A: Addition on account of unverified and unconfirmed advances cannot be done when assessee furnishes sufficient evidence to prove the receipt of advances

Dy. CIT vs. Ankit Builders Pvt. Ltd. (ITA No. 1594/Del/2011, dtd. December 22, 2017)

Facts

During the course of assessment, the AO observed that advances from customer in balance sheet and in absence of any details he made addition. During the appellate proceedings, the assessee explained that it purchased a plot of land and constructed a commercial building on the said plot. After purchasing the plot, it sold almost entire space to customers, who deposited purchase cost in installments. The assessee regularly received payments from the customers, which were shown under the head advance from customer in the books of account. After completion of the space purchased by the customers, the registration documents were prepared and respective spaces were registered in their name and the amount received from the customer as advance from customer were transferred to the sales account. And the customers, whose registration documents could not be prepared, their advances continued to remain in the head “advance from customers”. The assessee provided the list of customers whose advances were appearing under the head advance from customers. The CIT(A) considered the same and forwarded to the AO for his comment. During the remand proceeding, the assessee produced documents/affidavits from the said customers. The AO in his remand report discussed advances from each person.

Held

The AO himself recorded that advances are fully verified, and few credits, the assessee had furnished affidavits from the customers, further the customers have already shown the registered sale deed and payment made. Some of the advances have been received in earlier years. Therefore, addition on account of unverified and unconfirmed advances could not be made when the assessee furnished sufficient evidence to prove the receipt of advances.

Business expenditure – Section 37(1) of the Act – expenditure not allocable to any specific development project is revenue in nature and has to be allowed under section 37(1) of the Act.

Gitanjali Indratech Ltd. vs. ACIT (ITA 1365/Mum/2016 dtd. December 31, 2017) Assessment Year: 2012-13

Facts

The assessee was engaged in the business of construction and development. A search and seizure action was carried out on the Gitanjali group including assessee's premises on November 29, 2011. During the course of assessment proceedings the AO observed that the assessee had declared income towards other income of ₹ 1,53,21,565 i.e. Bank and Bond interest, Short Term Capital on mutual funds and against the said income claimed interest expenses of ₹ 95,87,250 and other expenses being employee cost expenses of ₹ 17,48,371, depreciation of ₹ 1,46,173 and other expenses of ₹ 29,26,884. Thus, the AO observed that during the year no business income had been returned by the Assessee and accordingly, these expenses could not be allowed. Thus, the AO disallowed said expenses and treated the same as capital work-in-progress. On appeal, the CIT(A) restricted the disallowance at 50% without any basis. The assessee, therefore, being aggrieved by the order passed by the CIT(A) preferred the appeal before the Tribunal.

Held

The Tribunal held that from the details of expenditure it was clear that these expenditures were in the nature of administrative expenses. The assessee's project for development and construction was in nascent stage and thus, the said expenditure could not be attributed to any specific project. The Tribunal further held that the said expenditure could not be held as work-in-progress because this expenditure was rightly incurred and it was not giving any enduring benefit to the assessee. Going by the nature of expenditure, it was clear that these were revenue in nature and hence, allowable under section 37(1) of the Act.

Demand and Interest – Sections 201(1) and 201(1A) of the Act – no demand can be levied and interest can be levied without examining the nature of services provided under section 194C and 194J of the Act

ACIT (TDS) vs. M/s. Nexygen Educational Trust (ITA Nos. 1152, 1153, 1154 & 1155/Hyd/2016 dtd. October 31, 2017) Assessment Years: 2012-13, 2013-14, 2014-15 & 2015-16

Facts

The assessee was a trust, running educational institutions. The trust entered into service agreement with K-12 Educational Management Pvt. Ltd. and Varsity Education Management Pvt. Ltd. for rendering services as may be required in relation to administrative, management and operation of educational institutions. For rendering services from K-12 and Varsity, the assessee was making payments as per the agreements and deducted the tax as per section 194C of the Act considering the agreements as 'Works Contract'. A survey action under section 133A of the Act was conducted in the premises of assessee wherein the AO noticed that services provided to the assessee were in the nature of technical services. Thus, tax was required to be deducted at the rate of 10% under section 194J of the Act. The AO was of the opinion that there was short deduction of tax and raised demands under section 201(1A) towards interest for the deferred payment. The demand was also raised on certain payments to Varsity in AY 2013-14 under section 201(1) and in AY 2015-16 on entire payments on the reason that assessee failed to furnish necessary details for remittance of tax by the deductee in those years. On appeal, the CIT(A) held that the assessee had deducted tax at correct rate and deposited the same to the credit of Government. Thus, the assessee could be treated as 'assessee in default'. Consequently, the question of levy of interest under section 201(1A) would not arise. The department being aggrieved by the appellate order preferred the appeal before the Tribunal.

Held

The Tribunal held that CIT(A) has considered that assessee has correctly deducted tax under section 194C and the issue of demand under section 201(1) was considered as an alternative plea. However, it was noticed that certain amounts were to be considered under section 194J. Therefore, the issue of considering the amount under section 194C or 194J of various services rendered was to be restored back to the AO for verification afresh keeping in mind the services rendered, the principles of law involved and the facts of the case. If the assessee satisfied that the deductees have paid taxes, the proviso to section 201(1) may apply and no further demand under section 201(1) can be raised. Thus, the AO was directed to examine the nature of services and which of the services were falling under section 194J, then examine whether a demand under section 201(1) could be raised in AY 2013-14 and 2015-16.

With respect to levy of interest under section 201(1A), whether interest was to be levied, if there was a short deduction of tax. Therefore, categorisation of services was required to be considered for the short deduction. The Tribunal held that the AO was not correct to treat all the services as 'technical services' in nature and it was also not correct on the part of the CIT(A) to give a finding that there was no human element in rendering the services which attracted section 194J. Thus, to the extent of levy of interest under section 201(1A) was concerned, the issue was to be examined whether any of the services are required to be considered under section 194J, then the AO was statutorily required to levy interest under section 201(1A), even though no demand is raised under section 201(1). Further, it was noticed that there was a merit in assessee's contention that the deductees have paid taxes. Therefore, following the principles laid down by Hon'ble Karnataka High Court in the case of *CIT (TDS) vs. Bharat Hotels Ltd. [384 ITR 77 (Kar.)]*, there cannot be any interest under section 201(1A). The assessee filed statement which shows that the deductees have paid advance taxes. However, these are required to be examined by the AO in the light of taxes paid and returns filed. The issue of levy of interest under section 201(1A) for the duration of interregnum period i.e., from the date of payment on which TDS was to be made and to the dates on which payments of tax by the deductees was required to be levied after due examination of facts.

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION

Case Law Update

A. HIGH COURT

1. The Court dismissed Revenue's appeal against Tribunal's exclusion of comparables in the absence of substantial question of law. Further, it held that foreign exchange fluctuations arising out of operations to be considered as operating income and that notional income on account of delayed payment could not be treated as part of income where the assessee was a debt free company

Pr.CIT vs. B.C. Management Services Pvt. Ltd.-TS-948-HC-2017 (Del.)-TP-ITA No. 1064 / 2017

Facts

i) The assessee was engaged in the business of providing IT enabled services i.e, Application and infrastructure development and testing, system and performance operations management and support etc. to its associated enterprises.

ii) The matter was referred to the TPO who selected his own comparable companies (*inter alia* including E-clerx Pvt. Ltd., ICRA Techno Analytics Ltd, TCS E-serve and Accentia Technologies Ltd) and made an adjustment to the tune of ₹ 2,89,52,326. Further, while computing PLI, the TPO contented that foreign exchange gains were not to be included while computing the operating income of the assessee. The TPO also made an addition on account of notional interest on delay in receipt of payment of receivables from the AE.

iii) Aggrieved, the assessee filed objections before the Hon'ble DRP wherein the DRP granted partial relief to the assessee directing the TPO to exclude Accentia Technologies from the list of comparables on the ground that it was engaged in KPO Services not comparable to the assessee. However, the rest of the additions made by the TPO were sustained.

iv) Aggrieved, the assessee as well as the Revenue preferred appeals before the Tribunal. The Tribunal held that the following companies selected by the TPO could not be considered as comparable assessee:

- E-clerx Pvt. Ltd., on the ground that it provided high value financial services relating to consultancy business and solution testing besides the web content management merchandising execution, web analytics, etc. and did not have adequate segmental results.
- ICRA Techno Analytics Ltd. on the ground that it was engaged in processing and providing software development and consultancy and engineering services/web

development services and did not have adequate segmental results.

- TCS E-serve as it had a brand value of TATA which had a significant positive impact on its profit.
- Accentia Technologies Ltd. on the ground that it was engaged in providing KPO services in the healthcare sector.

Further, the Tribunal also deleted additions made by the AO on the ground of including foreign exchange gains as operating income as well as additions of notional interest.

v) Aggrieved, Revenue appealed before the Hon'ble High Court against Tribunal's exclusion of the four comparables as well as inclusion of foreign exchange gain as operating income and the deletion of addition on account of notional interest on receivables.

Held

i) *Vis-à-vis* the issue of comparables, the Court dismissed the appeal of the Revenue and held that the Tribunal had assigned clear reasons for exclusion of comparables and that accordingly no substantial question of law arose.

ii) Further, in respect of inclusion of foreign exchange as operating income, the Court relying on the decision of the Division Bench in *Pr. CIT vs. Ameriprise India Private Limited [ITA No. 206/ 2016]* held that the foreign exchange gains earned by the assessee in relation to trading items and emanating from the international transactions could not be treated as non-operating losses and gains. Further, it dismissed the contention of the Revenue that as per the Safe Harbour Rules, the foreign exchange gains were to be considered as non-operating, observing that the Safe Harbour Rules were notified in 2013 and were not applicable to the impugned assessment year i.e., AY 2011-12.

iii) Further, in respect of addition on account of notional interest, the Court, relying on the decision in the case of Bechtel India Pvt. Ltd. [ITA No. 379 / 2016] held that notional income on account of delayed payment could not be treated as part of income where the assessee was a debt free company as the question of receiving of interest on receivables would not arise in such situations. Accordingly, it dismissed Revenue's appeal.

2. Where the assessee was receiving royalty from its AE in prior years for the provision of expertise and brand name, a mere change of ownership structure of the AE would not justify the contention that no royalty was charged in the current year

Dabur India Ltd vs. Pr.CIT – TS- 979-HC-2017(DEL)-TP- ITA No. 1142/ 2017 & CM No. 45221/ 2017

Facts

i) The assessee provided its UAE based AE viz., Redrock with expertise and also permitted it to use its brand name 'Dabur' in consideration of a royalty fee of 1% of sales (in accordance with an agreement between the two parties). Subsequently, the assessee acquired 100% shareholding in Redrock and changed its name to Dabur International Ltd., pursuant to which the AE ceased to pay royalty to the assessee.

ii) During the assessment proceedings, the TPO observing the agreement prevalent between the assessee and its AE in the earlier years, computed royalty chargeable from Dabur International Ltd. at 4% (@ 3% on alleged technical support/know-how provided by the assessee to the AE for the manufacture of items and 1% for products manufactured without the aid and support of the assessee). Accordingly, it made an adjustment of ₹ 544.69 lakhs.

iii) On appeal, the CIT(A) upheld the TPO's findings and dismissed the contention of the assessee that in the absence of the agreement in the current year no addition could be made and held that it was undisputed that the AE was permitted to use the brand name Dabur and therefore as per TP Regulations, the transaction required benchmarking irrespective of existence/ non-existence of an agreement. However, noting that most of the products manufactured by the AE were without the support of the assessee, the CIT(A) reduced the ALP royalty rate to 2% taking the average of the two categories of transactions.

iv) Aggrieved, the assessee preferred an appeal before the Tribunal. The Tribunal, noted that in the current year, the products manufactured by the AE were different from the Indian products manufactured by the assessee in terms of raw material and medium of manufacture. It however observed that the AE was still using the brand name of the assessee. Accordingly, it held that the addition made by the CIT(A) of 2% was excessive and opined that a royalty rate of 0.75% would be reasonable. It noted that during the year under consideration, the assessee had incurred significant expenses on marketing and brand building itself and considering in the preceding year the assessee had charged a royalty of 1 per cent for goods produced without the assistance of the assessee, it held that 0.75% was an appropriate rate for the year under consideration.

v) Aggrieved, the assessee filed an appeal before the High Court

Held

i) The High Court rejected assessee's contention that mere absence of consideration for use of the Dabur brand *per se* could not amount to an international transaction. It held that if the assessee's contention was to be accepted any omission by a party to indicate an initial income, which was concededly being shown in the past as an international transaction, could not be scrutinized at all, which would lead to absurd results and therefore could not be accepted.

ii) It held that since in the prior years, royalty was charged by the assessee to its AE and that a mere change of ownership pattern would not justify the non-charging of royalty. Accordingly, it held that there was no infirmity with the Tribunal's order and held that no substantial question of law arose.

3. The Court held that a comparable cannot be excluded only on the ground that it had a high turnover. Further, it held that a company could not be excluded merely because it was a Government owned company

CIT vs. Same Deutz-Fahr India Private Limited – TS- 973-HC-2017 (MAD)-TP – Tax Appeal No. 567 of 2017

Facts

i) The assessee, Same Deutz – Fahr India Private Limited, was a part of the SAME Group of companies. In respect of its international transaction of purchase of raw material and components, the assessee adopted TNMM as MAM and identified 5 comparables and also claimed an adjustment on account of idle capacity on comparables to arrive at ALP.

ii) During the assessment proceedings, TPO rejected 4 of the comparables selected by the assessee and conducted a fresh search and included HMT Ltd. and Mahendra Gujarat Tractors as comparables. However, later on rejected both these comparables (HMT on the ground that its turnover was more than twice the turnover of the assessee) and proceeded to finalize the proceedings based on one comparable which led to an upward ALP adjustment.

iii) Aggrieved, the assessee filed an appeal before the CIT(A) challenging the exclusion of HMT on the grounds of turnover. The CIT(A) upheld the order of the TPO.

iv) Aggrieved, the assessee filed an appeal before the Tribunal, wherein the Tribunal noting that HMT Ltd. was functionally similar to the assesseeand that the turnover filter of 3-5 times had been accepted in the Tribunal decisions for selecting comparables, included HMT as comparable.

v) Aggrieved, the Revenue filed an appeal before the High Court contending that the comparable being a Government company could not be considered as comparable.

Held

i) The Court, upheld Tribunal's observations and held that refusal to include the company as a comparable only on the ground that the company had far higher turnover was not justified.

ii) Regarding Revenue's argument that Tribunal failed to appreciate that HMT Limited was a Government owned company and the functions performed under Government management were altogether different from a private company, the Court opined that there was no provision of law that made any distinction between a Government owned company and a company under private management for the purpose of transfer pricing audit and/or fixation of ALP and accordingly held that a company could not be excluded on the ground that it is a Government company, more so where the company was functionally similar to the assessee.

iii) Further, it held that appeal lies under section 260A of the Act, only when there was a substantial question of law. Since the issue before it was a factual issue, the Court held that there was no question of law involved in the appeal and accordingly, dismissed the same.

B. TRIBUNAL DECISIONS

4. Whether Corporate/bank guarantee fees received by a foreign holding company cannot be treated as interest in view of 'Other Income' article under the India-UK tax treaty and it is taxable under the Income-tax Act – Held: Yes, in favour of the Revenue

Johnson Matthey Public Ltd. Company vs. DCIT [TS-578-ITAT-2017(Del.)] Assessment Year : 2011-12

Facts

i) The assessee is the ultimate parent company of both Johnson Matthey India Private Limited (JMIPL) and Johnson Matthey Chemicals India Private Limited (JMCIPL). The assessee provides various types of guarantee in relation to the business of its subsidiary companies.

ii) During the Assessment Year (AY) 2011-12, the assessee provided guarantees to support credit facilities extended to JMIPL and JMCIPL by banks in India. Guarantees provided to HSBC and Citibank on a global basis outside India include a guarantee for the facilities extended to JMIPL and JMCIPL. The assessee also received a sum of INR 5 million from JMIPL on account of the services rendered by senior management employee seconded by the assessee to India.

iii) While filing its return of income for AY 2011-12, the assessee treated the guarantee fees received from Indian subsidiaries to be in the nature of interest income under Article 12 (Interest article) of the tax treaty and offered tax at the beneficial rate at 15 per cent. Further, the payment on account of the seconded employee was treated as reimbursement and accordingly not offered to tax.

iv) The Assessing Officer (AO) treated the guarantee fee taxable under Article 232 (other income article) of the tax treaty and charged to tax at 40 per cent. The AO rejected the beneficial rate offered by the assessee under interest article of the tax treaty. The AO held that payment of INR5 million received on account of reimbursement of salary cost on behalf of Indian Associated Enterprise (AE) is taxable as Fee for Technical Services (FTS) under Article 13 of the tax treaty.

v) However, during the course of the appeal, the assessee raised an additional ground stating that since the source of guarantee fee, received for providing a guarantee for its AEs to foreign banks is outside India, it cannot be held to be taxable in India.

vi) The assessee contended that since it does not have a Permanent Establishment (PE) in India, the income earned in the form of fees charged for providing bank guarantee/corporate guarantee, in the normal course of business, would not be chargeable to tax in India. The assessee relying on the decision of *Capgemini S.A. vs. ADIT (ITA No. 7198/Mum/2012, dated 28th March 2016* contended that subsidiaries avail credit facilities pursuant to the corporate guarantee agreement entered into by the foreign parent outside India with a financial institution, the guarantee commission received by the foreign parent does not accrue nor does it deem to have been accrued in India and, therefore, not taxable in India under the Act.

Decision

The Tribunal held as under:

A) Taxability of guarantee fee

i) While as per Section 4 of the Act, income-tax shall be charged in accordance with, and subject to the provisions of the Act in respect of the total income of the previous year of every person, Section 5(2) of the Act states that, the total income of any previous year of a person who is a non-resident shall include all income from whatever source derived which is received or is deemed to be received in India in such year by or on behalf of such person; or accrues or arises or is deemed to accrue or arise to him in India during such year. In the cases covered under Section 5(2) of the Act, there are no escapes for the receipts from being included in the total income of the non-resident Indian.

ii) It is not the entering of the global corporate agreement outside India that occasions the assessee to charge the guarantee commission, but it is the act of the subsidiary is availing the loan that accrues the guarantee commission to the assessee.

iii) So long as there is no denial that the loan transaction took place in India, it is not open for the assessee to contend that no income accrued to them in India. The Tribunal relied on the decision of the Supreme Court in the case of *Kanchanganga Sea Foods Pvt. Ltd vs. CIT [2010] 325 ITR 540 (SC).*

iv) Accordingly, the Tribunal observed that the parental/bank guarantee commission was accrued and received by the assessee in India and hence such a receipt is taxable in India.

B) Whether guarantee fee is taxable as 'interest' or 'other sources'

i) On a bare reading of the definition of interest provided under Section 2(28A) of the Act and Article 12(5) of the tax treaty, it indicates that either the debt claims of any kind or the service fee or other charge in respect of moneys borrowed or debt incurred, refer to the payments relating to the debt proper, whether or not there is any relationship of debtor-creditor or borrower-lender.

ii) The Tribunal observed that words and phrases employed in any provision of statute or tax treaty have to be understood in the context of their usage and with reference to the company of other words or phrases they keep in. Too much of expansion of the literal meaning, in disregard to the context or privity of the contract would lead to absurdity or negation of the purpose of the provisions. The word 'interest' as provided in Article 12(5) of the tax treaty and Section 2(28A) of the Act, shall have to be understood contextually and with reference to the other words and phrases in whose company it is to be found.

iii) Though the words 'claims of any kind', or 'service fee or other charge' are to be found either in the tax treaty or in the Act, with reference to interest, every periodical payment or remuneration for service in the context of a loan cannot be treated as 'interest'. The term interest, with its widest connotations, indicate the payments, whatever may be the name that is called with, relates to the payments made by the receiver of some amount, pursuant to a loan transaction.

iv) A loan transaction is also a species of contract. Article 12(5) of the tax treaty and Section 2(28A) of the Act extend the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as 'interest', necessarily have to be within the context of the loan and shall relate to the parties to the privity of contract. In this context only, the expressions 'claims of any kind', 'service fee or other charge' have to be understood. So also the expression 'whether or not there is the relationship of creditor-debtor or lender-borrower exists'.

v) It is only in the context and privity of contract, the payments covered by Article 12(5) of the tax treaty or section 2(28A) of the Act would be qualified to be treated as interest, even if there is no semblance of a relationship between the parties like that of creditor-debtor exists. However, it does not take into its fold any payments made to a stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan.

vi) Undoubtedly, the assessee is a stranger to the privity of loan transactions inasmuch as the contract of loan is different from the contract of guarantee. In our considered opinion, the expression of 'debt claims of any kind' or 'the service fee or other charge in respect of money borrowed or debt incurred' does not stand extended to the payment of guarantee commission received by the assessee in India.

vii) The payments relating to debt claims, service fee or other charge, could be categorised as interest provided they are privity of such contract. The thin line that separates the payment of interest from other payments will be missing and the payments towards consultancy charges, expenditure incurred for the purpose of pre-loan documentation and the host of expenditure incurred with third parties and not relatable to the loan transaction proper, will have to be treated as 'interest'. Certainly, it cannot be the intention of the legislature or treaty-makers.

viii) The Tribunal held that, so long as the assessee is a stranger to the privity of the contract of the loan between the Indian entity and the banker, they cannot categorise the corporate/bank guarantee recharge amount as interest for the purpose of taxation.

Taxability of bank guarantee as business income

i) The Tribunal observed that the assessee is manufacturing technologically advanced chemicals known as catalysts used in automobile and other industries. It manufactures a variety of precious metal containing catalysts and chemical products which are used in a wide range of industrial applications. From the facts of the case, it indicates that the assessee was not involved in the business of providing corporate/bank guarantee recharge to earn income on a regular basis. The global corporate guarantee that was entered into by the assessee is only for the limited purpose of securing loans to its subsidiaries, and the recharge income is only an incidental one. In these circumstances, the Tribunal observed that it is difficult to accede the argument that the corporate/bank guarantee recharge would be a business profit, for the application of Article 7 of the tax treaty.

Taxability of bank guarantee as FTS

i) With respect to the contention of the assessee that the corporate/bank guarantee recharge could be regarded as FTS, the Tribunal observed that the payment does not relate to the tendering of any technical or consultancy service and the question of making available any knowledge, experience, skill know-how or process or consist of any development or transfer of a technical plan or a technical design. At the same time, it does not also meet the requirement of Explanation to Section 9(1)(vii) of the Act.

Therefore, the Tribunal observed that guarantee recharge amount is not FTS.

ii) Having examined the issue of corporate/ bank guarantee recharge with reference to Article 12(5) of the tax treaty and Section 2(28A) of the Act, the Tribunal is of the opinion that the lower authorities are correctly justified in concluding that the payment does not fall within the expression of interest and in view of other income Article of the tax treaty, in the absence of any specific provision dealing with corporate/ bank guarantee recharge, the same has to be taxed in India as per the provisions of the Act.

Taxability of secondment fees

i) The Tribunal agreed with the assessee that applicability or otherwise of the ratio of the jurisdictional High Court in the case of *Centrica India Offshore (P.) Ltd. vs. CIT [2014] 364 ITR 336 (Del.),* is a fact-specific question to be determined with reference to the functions performed and the conduct of the duty of the seconded employee with reference to the business of the assessee and the Indian entity. The principles laid down by the jurisdictional High Court in the case of Centrica are that the secondment agreement was required to be examined in the light of certain questions. These questions are to be answered with reference to the secondment contract, secondment agreement, employment contract and salary reimbursement agreement, which, when read together point out either points of similarity or distinction between these two cases and more particularly, whether the employees have been released from their work and subsequently they entered into a separate local employment agreement with Indian AE.

ii) The documents filed by the assessee do not share any light on these questions. The inference that could be drawn from the documents filed by the assessee scarcely distinguish the present case from Centrica and the documents produced by the assessee are no substitute for the secondment contract and secondment agreement, and for the failure of the assessee in the discharge of its burden of proof. Therefore, the Tribunal directed the assessee to produce the relevant documents before the AO and set aside the issue to the file of the AO to give a fresh finding after looking into the documents to be produced by the assessee.

Comment

The assessee relied on the decision of Mumbai Tribunal in the case of *Capgemini S.A. vs. ADIT (ITA No. 7198/Mum/2012, dated 28th March, 2016)* wherein it was held that guarantee commission received by a foreign company did not accrue in India nor it can be deemed to be accrued in India, therefore, not taxable in India under the Act. Further, as per Article 23(3) of India-France Tax Treaty, income can be taxed in India, only if it arises in India. The Mumbai Tribunal held that the income arises in the overseas country since the guarantee was given by the foreign assessee in the foreign country and, therefore, Article 23(3) of the India-France Tax Treaty does not apply as income does not arise in India. However, the Tribunal in the present case has held that the bank guarantee commission was accrued to and received by the assessee in India. It is not the entering of the global corporate agreement outside India that occasions the assessee to charge the guarantee commission, but it is the Act of the Indian subsidiary availing the loan that accrues the guarantee commission to the assessee.

5. Whether an Indian group company of a U.S. entity does not constitute a PE in India under the India-U.S. Tax Treaty – Held: Yes; in favour of the Revenue assessee

SPE Networks India Inc. vs. DCIT (2017-TII-208-ITAT-MUM-INTL) Assessment Years: 2005-06 to 2010-11

Facts

i) The assessee, a U.S. resident, engaged in the business of operating satellite television channels, marketing, and distribution of the television channels. During the year under consideration, the assessee was operating two channels namely ANIMAX and AXN. For the purpose of marketing its channels, the assessee had appointed SET India Private Ltd. (SET India) as a non-exclusive advertising and sales agent for canvassing airtime for the assessee channel on a principal to principal basis.

ii) The assessee had also granted rights to SET India to distribute TV channels in India for an agreed consideration at 70 per cent of the revenues collected by SET India from the distribution of ANIMAX channel in India with a minimum guarantee and 75 per cent of the revenue collected and the bonus fee in the case of AXN channel.

iii) The assessee had claimed that it did not have a PE in India and therefore the income arising to it was not taxable in India under Article 7 of the tax treaty.

iv) The Assessing Officer (AO) held that the arrangements between the assessee and SET India was not of principal to principal and it was about sharing the actual revenue collected from advertisers and the cable operators. The assessee had a business connection in India, and hence, the income attributable to the business operations of the assessee was taxable in India. The assessee also had a dependent agent PE in India under Article 5(4) of the tax treaty. As per Rule 10 read with Rule 10(iii) of the Income-tax Rules, 1962 (the Rules) the AO estimated the assessee's income at 10 per cent of gross advertisements as well as subscription revenue received by SET India on behalf of the assessee in India.

v) The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Decision

The Tribunal held in favour of the assessee as under:

From the perusal of the agreements, it becomes clear that the assessee was carrying out its operation from U.S. and not from India. Both the activities, i.e., Sale of advertisement inventory and distribution of AXN and ANIMAX channels were not carried out in India. The assessee did not have any office premises or a fixed place of business in India at its disposal, and none of its employees were based in India through whom it could render the services in India. Thus, it has been held there was neither fixed base PE nor service PE of the assessee in India.

Though the CIT(A) has endorsed the view of the AO that the assessee had agency PE, but nothing has been brought on record to prove that the agreements between the assessee and SET India was not on principal to principal basis. SET India had no authority to conclude any contract on behalf of the assessee in India.

On the other hand, while selling the airtime inventory and distributing AXN and ANIMAX channels in India, SET India would act in its own right and not on behalf of the assessee. It was not dependent on the assessee economically or legally. It is also a fact that SET India also carried out significant marketing and estimation activities for other channels namely Set, Set Max and HBO. Therefore, SET India has to be treated as an independent entity which carried out its own business employing its own capital and bearing connected risks. It cannot be treated an agent, a dependent agent, of the assessee. SET India would purchase airtime from the assessee and would sell the same in India in its own right, and the assessee had no control over it.

The Tribunal observed that the revenue earned by SET India was not on behalf of the assessee. It was making payment to the assessee for the purchases made by it. It was not subject to any control of the assessee as far as conducting of business in India was concerned. The activities of SET India were not devoted wholly or almost wholly for the assessee.

The Tribunal has also taken note of the facts that the revenue of the assessee was not entirely dependent on the earning of SET India. The employees of SET India would work only for SET India and not for any other entity of the group. The lower authorities have not alleged that the transaction between the assessee and SET India were not at arm's length. Further, in the Transfer Pricing (TP) orders the TPOs have held that no TP adjustments were required to be made to the income of the assessee on account of advertisement revenue or distribution revenue.

Since the assessee did not have business connection in India as well as agency PE/fixed base PE and SET India was not an agent of the assessee, it has been held that the AO had wrongly invoked the provisions of Rule 103 of the Rules.

Comment

The Mumbai Tribunal in the case of *NGC Asia Network LLC vs. JDIT (2016) 175 TTJ 403 (Mum.)* held that the Indian group company of a foreign company had been habitually exercising in India an authority to conclude contracts on behalf of the foreign company which are binding on the foreign company. Therefore, the Indian company has been treated as a dependent agent PE in India under the India-U.S. tax treaty. However, the Mumbai Tribunal in the case of *DDIT vs. B4U International Holdings Ltd. (2012) 148 TTJ 274 (Mum.)* held that the Indian agents of a Mauritian company do not create an agency PE under the India-Mauritius tax treaty since they neither have authority to conclude contracts nor habitually exercise such authority.

6. Third party reimbursements routed through parent not taxable absent rendering of services

ADIT vs. The Timken Company [TS-569-ITAT-2017 (Kol.)] Assessment Years : 2004-05 to 2007-08

Facts

i) The Timken Company ('assessee'), a company incorporated and a tax resident of USA, engaged in the business of manufacturing and sale of bearings, entered into an agreement with Timken India Limited ('TIL') (subsidiary of the assessee), pursuant to which the assessee agreed to render various services in the nature of Business Strategy Development Services to TIL in USA and no part of the same was to be rendered in India.

ii) The services are incurred at centralized level for all the subsidiaries and associated companies and the total costs incurred by the cost centres were allocated to the group companies on the basis of "Allocation Key" on a scientific and actual basis. It was also agreed that the compensation payable by TIL to the assessee for the services would cover only the cost actually incurred by the assessee without any profit element or mark-up on the cost. TIL did not deduct tax on the payment made to the assessee contending that the sum payable to the assessee under the Agreement represented only recovery or reimbursement of costs or expenses actually incurred by the assessee while rendering the said services and there was no element of profit or income for the assessee in respect of such payment.

iii) Therefore, it was of the view that since there was no income chargeable to tax in the hands of the assessee, it was not required to deduct any tax on the payment made. The assessee contended that the payments by TIL did not constitute fees for included services within the meaning Article 12(4) of the Indo-US DTAA since the company did not make available technical knowledge, experience, skill etc. It represents business profits, which is not taxable in India in absence of PE in India.

iv) The AO observed that the AAR in the assessee's case had held that the reimbursement of cost of services would be taxable in India as per Article 12 of Indo-USA DTAA. Therefore, held that such reimbursement was taxable in India in the hands of the assessee. CIT(A) upheld the order of the AO.

Decision

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

i) The Tribunal observed that in order to attract the taxability of an income under Article 12(4)(b) of Indo-USA DTAA, not only the payment should be in consideration for rendering of technical or consultancy services, the services so rendered should also be such that 'make available' technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design. It further observed that Sec. 9(1)(vii) Explanation 2, stops with the 'rendering' of technical services and the DTAA goes further and qualifies such rendering of services with words to the effect that the services should also make available technical knowledge, experience, skill etc. to the person utilizing the services. ITAT also relied on the Mumbai ITAT decision in the case of Raymond.

ii) The Tribunal perused the agreement between the assessee and TIL and observed that the nature of services are purely in the nature of advisory services and nothing was made available to TIL by the assessee. It further noted that example 7 given under MoU between the India and USA makes it clear that consideration for advisory services rendered cannot be treated as fees for included services under Article 12(4)(b). It further observed that there was no material on record to show that technology was made available and TIL was permitted to apply the technology in the sense that the fruits of the services remained available to TIL in some concrete shape such as technical knowledge, experience skill etc.

iii) Accordingly, it held that CIT(A) erred in holding that the monies received by the assessee from TIL constitute 'fees for included services' within the meaning of Article 12(4) of the India-US treaty, and are accordingly liable to be taxed in India. It further held that since, the assessee does not have any permanent establishment in India, the incomes so arising to them in India cannot be taxed under Article 7 as 'business profits'.

iv) Further, with respect to the payments received by the assessee from TIL on account of certain services rendered to TIL by some third parties for which the assessee made payments and which TIL reimbursed to the assessee (referred to as "Charge Back Receipts"), the assessee contended that it acted only as a conduit and derived no income from such reimbursements since they were at actual amounts spent by the assessee on behalf of TIL and no profit element was involved. Accordingly, such reimbursements were not taxable in India.

v) The Tribunal observed that the kind of services were 'legal expenses', 'inspection and survey charges of cargo and vehicles' and 'travelling expenses'. ITAT observed it was third parties who had rendered services to TIL. The actuals billed by the third parties were paid by the assessee in USA and were later on reimbursed by TIL to the assessee in India. Therefore, ITAT held that the payment of reimbursements were not in the nature of FTS as the assessee was not the ultimate beneficiary of the sum in question nor did it render any service to TIL. Further, it held that there was no evidence brought on record to show that the technical skill, knowledge etc., were made available to TIL by the Assessee. At best the sum was taxable only in the hands of the persons who provided the services to TIL and not in the hands of the assessee. It further observed that the TPO scrutinized the details of reimbursements while examining the international transaction of reimbursement by TIL to the assessee u/s. 92 and found that the assessee made no profit on such reimbursements and that the reimbursements were at arm's length.

Comment

The *Bangalore Tribunal in Tungabhadra Steel Products Ltd. [TS-485-ITAT-2017(Bang.)]* had upheld disallowance u/s. 40(a)(ia) for assessee's failure to deduct TDS on management charges reimbursement to its holding company. Also, *Delhi Tribunal in SMS Iron Technology Pvt. Ltd. [TS-555-ITAT-2017(Del.)]* had rejected assessee's contention that payment made by assessee (Indian subsidiary company) to its German parent towards intranet charges and SAP software was only reimbursement of expenditure.

CA Chirag Mehta & CA Hemant Regmi

INDIRECT TAXES
GST Gyan

Exim Trade (Goods) Under GST

Introduction

The gamut of export-import (EXIM) trade covers within its scope not just export and import of goods or services *per se*, but also various trades that happen in the course of import and export. In the case of goods these transactions typically include high sea sales, sale from bonded warehouse, deemed exports and the like. This article covers an in-depth analysis of the export of goods side of the transactions in foreign trade. The subject of export of services and import side of foreign trade in goods shall be dealt in the subsequent issue of the Chamber's Journal.

The introduction of GST not only led to consolidation of number of indirect tax levies but also to some extent led to loss of significance of the distinction between 'goods' and 'services'. GST applies on all "supplies" of goods or services. Accordingly, exports may be that of goods or services. The major difference between export of goods and services is that, in case of goods the condition of receipt of foreign exchange is not attached to supply of goods but in case of services this is a pre-condition.

GST Law in India is implemented as a destination based consumption tax where tax is levied on supplies consumed domestically. In other words the tax should finally reach the place of consumption of the supply which is sought to be taxed. In case of export supplies the consumption takes place outside the taxable territory and hence the tax should not get exported. Accordingly, exports are zero rated since the consumption is not domestic. This also ensures export supplies from India are more competitive in international trade.

Article 286[1] of the Constitution of India puts a restriction on States power to levy tax on any supply of goods or services outside the State or in the course of export from India or import into India. Further, Article 269A[2] empowers the Union Government to levy and collect GST on inter-state supplies of goods and services including exports and imports. Accordingly sections 7(2) and 7(5) of the IGST Act, 2017 state that supplies of goods or services that are imported into/exported from India shall be treated as inter-state supplies and shall be governed by the IGST Act.

1 As amended by 101st Constitutional Amendment Act, 2016

2 As inserted by 101st Constitutional Amendment Act, 2016

Before we move on to examine GST implications on specific transactions that take place in international trade it would be relevant to understand certain basic concepts.

Meaning of 'India' Under GST Law

In case of export-import transactions either the location of the supplier or the place of supply are is in India. Hence, it is of utmost importance to understand the meaning of 'India' for the purpose of GST Law as defined in section 2(56) of the CGST Act. The same is reproduced here under:

"India" means the territory of India as referred to in ***Article 1 of the Constitution, its territorial waters,*** *seabed and sub-soil underlying such waters,* ***Continental Shelf, Exclusive Economic Zone*** *or any other Maritime Zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 (80 of 1976)*[3]*, and the air space above its territory and territorial waters.*

Under constitution Article 1 defines India as under:

1 *Name and territory of the Union*

(1) *India, that is Bharat, shall be a Union of States*

(2) *The States and the territories thereof shall be as specified in the First Schedule*

(3) *The territory of India shall comprise*

(a) *The territories of the States*

(b) *The Union Territories specified in the First Schedule*

(c) *Such other territories as may be acquired.*

It is clear from the above that the territories of the States and the Union Territories are fixed in terms of First Schedule to the Constitution. India is a union of States however the territory of India is not limited to the territories of the respective States but also includes other territories as may be acquired.

The Maritime Zone Act *vide* Section 3(1) thereof provides that the sovereignty of India extends to **territorial waters**, sea bed and subsoil underlying such waters and the air space over such waters. The limit of territorial waters is fixed at 12 nautical miles from the baseline as per Section 3(2) of the Maritime Zone Act.

The **Continental Shelf of India**[4] comprises the seabed and subsoil of the submarine areas that extend beyond the limit of its territorial waters throughout the natural prolongation of its land territory to the outer edge of the continental margin or to a distance of two hundred nautical miles from the baseline where the outer edge of the continental margin does not extend up to that distance.

The **Exclusive Economic Zone** ('EEZ')[5] of India is an area beyond and adjacent to the territorial waters, and the limit of such zone is two hundred nautical miles from the baseline

The definition of "India" under the GST Law is wide enough and covers an area up to 200 nautical miles from the baseline. Hence, it is evident that for a transaction of supply of goods to be regarded as export as defined in Section 2(5) of the IGST Act the goods should move to a destination outside the EEZ (i.e. 200 nautical miles from the baseline)

Zero Rating of Exports

The objective of zero rating of exports is achieved in terms of Section 16(3) of the IGST

3 Hereinafter referred to as the "Maritime Zone Act"

4 Section 6 of the Maritime Zone Act

5 Section 7 of the Maritime Zone Act

Act. It may be noted that input Tax Credit and consequent refund can be claimed also in respect of exempt supplies[6]. In terms of Section 16 zero rating is achieved by allowing a refund of the tax (either the ITC or the tax paid on export). Export of goods is an inter-state supply. Section 24 of the CGST Act makes it mandatory for a person making inter-state supply to get registered. Also the benefit of zero rating of export is available only to a registered exporter.

Section 16(3) of the IGST Act provides two options to an exporter to zero-rate his export:

1. Export the goods or services without payment of IGST and claim refund of unutilised Input Tax Credit, or;

2. Export the goods or services on payment of IGST and claim refund of the IGST paid at the time of export.

For claiming the zero rating various conditions, restrictions and procedures have to be followed which have been prescribed in the Rules and the notifications. Export procedures relating to goods have been elaborated in the subsequent paragraphs

Export of goods

Export of goods has been defined in Section 2(5) of the IGST Act which is reproduced hereunder:

2(5) "Export of goods" with its grammatical variations and cognate expressions, means taking goods out of India to a place outside India;

On reading the definition it is evident that for a supply of goods to qualify as an export, the goods should be physically present in India so that they can be taken out of India. Further, these goods should move to a destination outside India. We have already discussed at length the meaning of 'India' for the purposes of GST Law. For example warranty supplies of machine parts made on behalf of foreign parent to the parent's customer in India cannot amount to an export since the goods do not physically move outside 'India'. The exporter can export the goods either without payment of IGST or on payment of IGST.

Export of goods without payment of IGST

Under this option the value of exported goods shall not be liable for payment of IGST and the exporter shall be eligible to claim refund of unutilised Input Tax Credit[7]. This option is subject to certain conditions that are discussed here under:

1. Furnish prior to the export a Letter of Undertaking ('LUT') or Bond in Form RFD-11[8] to the jurisdictional Centre or State authority (depending under which authority is his GSTIN allocated)

2. Export the goods within 3 months (or extended period) from the date of export invoice

3. In case the goods are not exported within the above period the exporter shall be liable to pay tax along with interest which was earlier not paid

4. In case the exporter does not pay the IGST on non export within the stipulated time the LUT/Bond shall be withdrawn

Letter of Undertaking and Bond

Earlier Notification and Circulars provided the facility of LUT to restricted categories of exporters. However, various changes in the conditions and restrictions have been notified[9] recently and by and large the facility of LUT has been extended to all exporters. Existing conditions and safeguards regarding LUT and Bond have been tabulated hereunder:

6 Section 16(2) of the IGST Act

7 Section 54(3) of the CGST Act, 2017

8 Section 16(3)(a) of the IGST Act read with Rule 96A of the CGST Rules, 2017

9 Notification No. 37/2017-Central Tax, dated 04-10-2017

Particulars		Exception/Remarks
Eligibility	To any registered person who wishes to export without payment of IGST	Facility is not available to persons who have been prosecuted under the GST or any earlier law and where tax the amount evaded exceeds ₹ 2.5 lakhs Such exporters shall have to furnish a bond
Validity	The LUT shall be valid for the whole financial year in which it has been issued	• It may be noted that few Commissionerates have issued LUTs for a period of 12 months from the date of LUT being furnished • In case the conditions of export within prescribed time limit or realisation of foreign currency within time limit specified in Rule 96A has not been fulfilled the LUT facility shall be withdrawn till the tax has been paid with interest
Form	The LUT is to be furnished in Form RFD-11	Form RFD-11 has to be submitted on the letter head of the registered person in duplicate along with a self-declaration of the Exporter
Where to submit the LUT/Bond	• Central or State JC/AC having jurisdiction over the principal place of business of the exporter (depending on allocation of the taxpayer)	In case of multiple units within the same State the exporter shall apply for LUT/ Bond to the officer having jurisdiction over the principle Place of Business Recently, an order[10] of allocation of cases has been issued for distribution between Centre and State.
Documents to be annexed	A self declaration regarding conditions for LUT have been fulfilled has to be enclosed along with RFD-11	However, many Commissionerates have been demanding additional enclosures like PAN Card copy, etc.
Time limit for acceptance	To be accepted within a period of 3 working days of its receipt. **If not accepted in this time limit it shall be deemed to have been accepted**	-----
Bank Guarantee	To be furnished for 15% of the Bond amount	The bond amount would be for the self-assessed tax liability of the export value and applicable only in cases where LUT facility is not available
Running Bond Account	The exporter has to ensure that the bond amount is sufficient to cover the export value and it has to be monitored by the exporter himself	The sufficiency of the bond value may be checked by the Department at any time

10 Order No. 1/2017-GST/ Maharashtra, dated 22-11-2017 and Trade Circular No. 50T of 2017, dated 7-12-2017 issued by the Maharashtra State Tax Commissioner

Export of goods on payment of IGST

Alternatively, an exporter has an option to export the goods by making payment of IGST[11]. The payment of IGST shall be done by utilising ITC and balance through cash. Where the exporter chooses to export the goods on payment of tax it has been provided[12] that the shipping bill of export itself shall be considered as an application for refund. Such application shall be deemed to have been filed only when:

1. Export Manifest covering the shipping bill of the exporter is filed
2. The exporter has furnished a valid return in Form GSTR-3 or as the case may be GSTR-3B
3. Exporter furnishes details of export invoices in Form GSTR-1 or in standalone table 6A of GSTR-1 subsequent to filing of Form GSTR-3B where the date of furnishing GSTR-1 has been extended
4. The persons claiming refund of IGST paid on export of goods or services should not have received supplies under concessional rate or as deemed exports.[13]

Furnishing of export details in GSTR-1 – Table 6A

Table 6A of GSTR-1 is very critical for receipt of direct refund based on shipping bill. Table 6A[14] is reproduced hereunder:

GSTIN of recipient	Invoice details			Shipping bill/Bill of export		Integrated Tax			Central Tax			State/UT Tax			Cess
	No.	Date	Value	No.	Date	Rate	Taxable value	Amount	Rate	Taxable Value	Amount	Rate	Taxable value	Amount	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
6A. Exports															

Column No.	Comments
1	GSTIN column shall remain blank
2-4	• It must be ensured that the Invoice No. in the shipping bill does not exceed 16 digits since there is no restriction on No. of digits of invoice No. under the Customs Law • In case separate export invoice and commercial invoices are issued due care must be taken to ensure that the Invoice No. as per shipping bill is furnished in Table 6A
7-9	• In some cases it has been observed that in the shipping bill the value of goods has been considered as FOB and IGST has been calculated on such FOB value. However, the contract of export may be CIF. In such cases there may be a mis-match between value of export provided in the shipping bill as against the value arrived in terms of section 15 of the CGST Act. It is advisable that the CHA takes utmost care while filing of the shipping bill. In case of mis-match the shipping bill should be first amended before filing Table 6A/ GSTR-1

11 Section 16(3)(b) of IGST Act, 2017

12 Rule 96 of CGST Act, 2017

13 Rule 96(9) of the CGST Rules, 2017 inserted by Notification 75/2017-Central Tax, dated 29-12-2017 inserted w.e.f. 23-10-2017

14 As amended *vide* Notification No. 70/2017-CT, dated 21-12-2017

Supply Within 12 Nautical Miles

Tax jurisdiction in respect of sales made in territorial waters has been a matter of debate and litigation during the pre-GST regime. A question arose before the Hon'ble Karnataka High Court in the case of *Great Eastern Shipping Company Limited vs. State of Karnataka & Others*[15] it was held by the court that so far as the State which is surrounded by water the boundary of that State should be included as the part of the State and hence power to tax such sale should vest with the State. This case related to transfer of right to use tugs. Similarly, in case of *Raj Shipping and Bhambani Shipping vs. The State of Maharashtra*[16] it was held that there is sufficient territorial nexus for the MVAT Act to apply and that the sale taking place in the territorial waters shall be liable for payment of VAT since the appropriation of the goods happened within Maharashtra. It may be noted that applicability of taxes on sale within territorial waters needs to be examined based on facts of each case

The jurisdiction of the States over the territorial waters was much debated at the GST Council meetings. At its 9th meeting held on 16-1-2017 a consensus on issue of territorial jurisdiction was reached. It was recommended that an area of 12 nautical miles into the territorial waters will be under the jurisdiction of the Central administration. However, the States can collect tax on economic activities carried out in that area. Accordingly, section 9 was incorporated in the IGST Act which provided that where the supplier or the place of supply is in territorial waters it shall be deemed to be in the coastal State or Union Territory where the nearest point of appropriate baseline is located.

The provisions of section 9 of the IGST Act are reproduced hereunder:

9 Notwithstanding anything contained in this Act,–

(a) Where the location of the supplier is in the territorial waters, the location of such supplier; or

(b) Where the place of supply is in the territorial waters, the place of supply,

shall, for the purposes of this Act, be deemed to be in the coastal State or Union territory where the nearest point of the appropriate baseline is located.

Let us take an example where A of Maharashtra supplies to B of Gujarat goods at a location in territorial waters and that the location in the territorial waters is close to State of Gujarat. The location of the supplier (A) is in Maharashtra and the place of supply in view of Section 9 of the IGST Act shall be the State of Gujarat. Accordingly, the transaction would be an Inter-State transaction liable for payment of IGST (the place of supply being the State of Gujarat.

Supply Beyond 12 Nautical Miles

[Does the GST Law have jurisdiction beyond 12 nautical miles]

The sovereignty of India extends over the territorial waters of India. However, the position with respect to the continental shelf and EEZ is slightly different. In respect of these areas India has been only given limited sovereign rights which cannot be equated with India having sovereignty over these areas.

Sections 6(6) and 7(6) of the Maritime Zone Act empower the Central Government to notify any enactment in force in India to apply to the Continental Shelf, EEZ or any designated areas as if these areas were a part of territory of India. In the past notifications were issued for extending the jurisdiction of the Customs, Central Excise, Income Tax and Finance Act (i.e. Service Tax) to the EEZ. It may be noted that the definition of India was 2(27) of the Finance Act, 1994. In spite of the term India widely defined under the Finance Act a notification under the Maritime Zone was issued for extending the powers of Finance Act.

15 2004 (1) TMI 649 (Kar.)

16 2015 (10) TMI 2406 (Bom.)

In the case of *M/s Larsen and Toubro Ltd.*[17] the Hon'ble Gujarat High Court observed that when the sale of goods took place at Bombay High, for which the goods moved from Hazira to Bombay High, such movement does not get covered within the expression "movement of goods from one State to another" as contained in Section 3(a) of CST Act. It is clear that the goods had not been moved from one State to another since Bombay High does not form part of any State of Union of India. It *inter alia* stated that there was no notification issued under Sections 6 and 7 of the Maritime Zone Act to create a deeming fiction for CST Act to apply to the EEZ. In the absence of such notification, the court held that the Gujarat VAT authorities could not demand tax under the CST Act. A similar decision was rendered by the Bombay High Court in the case of *Pure Helium (India) Private Limited*[18]. A similar view has been taken by the Hon'ble Apex Court in case of Aban Loyd Chiles Offshore Limited.[19]

It may be noted that there is **no notification issued under the Maritime Zone Act for extending the jurisdiction of GST Law** to the Continental Shelf or EEZ. India is widely defined under the GST Law. However, in the absence of a notification under the Maritime Zone Act the powers of extending the jurisdiction to such areas may is debatable. Nevertheless taking such a position may be too aggressive.

The immediate example in this regards that comes to mind is that of offshore companies that are usually located beyond 12 nautical miles from the baseline. In the terms of the discussion above the jurisdiction of GST Law shall extend to services relating to offshore works contracts in respect of rigs owned by these companies beyond 12 nautical miles. The intention is clear from the Notification[20] issued by the Government consequent to the decisions taken at the 22nd Council meeting which has fixed a rate of 12% for offshore works contract services relating to oil and gas exploration in offshore area beyond 12 nautical miles

Nature of Levy in Case of Supplies Made to Areas in the EEZ

Having said that GST extends to supplies made in the EEZ, the next question that comes to mind is what levy would get attracted where supplies are made to areas located in the EEZ. At this juncture it would be important to examine Article 366(30) of the Constitution that defines 'Union Territory' to mean any Union territory specified in the First Schedule and includes any other territory comprised within the territory of India but not specified in that Schedule. Section 2(8) of the UTGST Act defines a "Union Territory" to include 'other territory'. Hence, the EEZ and Continental Shelf shall be governed by the UTGST Act and in respect of companies having offshore drilling platforms registration should be obtained for such offshore platforms under UTGST Act.

The determination of the nature of levy would depend upon the location of the supplier and the place of supply. For illustration let us take a case of a drilling contractor who is registered in the State of Maharashtra has contracted with a company for providing drilling services at the offshore location. Further, the offshore location of the company is registered under the UTGST Act. In such cases it cannot be said that the offshore location is a place of business of the contractor. Hence, his registered place of business in the State of Maharashtra shall be the location as a supplier of service in terms of Section 2(15) of the IGST Act. The place of supply as per general rule shall be the offshore

17 State of Gujarat vs. Larsen And Toubro Limited [(2016) 6 TMI 950 (Guj.)]

18 49 VST 14 (Bom)

19 Aban Loyd Chiles Offshore Limited vs. Union of India & Others [Civil Appeal No. 2236 of 2002 delivered on 11-4-2008 (SC)]

20 Entry 38 inserted in Notification No. 11/2017 *vide* Notification No. 31/2017-CT (Rate), dated 13-10-2017

location. Since the location of the supplier of service is the State of Maharashtra and the place of supply is in the Union Territory the transaction would be an inter-state supply of service liable for payment of IGST.

Deemed Exports

Section 2(39) of the CGST Act defines 'deemed exports' to mean supplies of goods as may be notified under section 147 of the said Act. Hence, deemed exports is a category of supply introduced by the Government under the GST law in terms of powers conferred under section 147 of the CGST Act. Provisions of Section 147 are reproduced hereunder:

147. *The Government may, on the recommendations of the Council, notify certain supplies of goods as deemed exports, where goods supplied do not leave India, and payment for such supplies is received either in Indian rupees or in convertible foreign exchange,* ***if such goods are manufactured in India.***

On a perusal of the above statutory provision following emerge:

1. Only supplies notified under Section 147 can qualify as Deemed exports
2. Only supply of "goods" can qualify for Deemed exports
3. The goods should be manufactured in India
4. The supply should be by a registered person

Export benefits are covered by Chapter 7 of the Foreign Trade Policy. Based on the FTP the Government has notified[21] certain supplies to be considered as deemed exports which are enumerated under:

1. Supply of goods by a registered person against Advance Authorisation
2. Supply of capital goods by a registered person against EPCG Authorisation
3. Supply of goods by a registered person to Export Oriented Unit
4. Supply of gold by a bank or Public Sector Undertaking specified in the Notification No. 50/2017-Customs, dated the 30th June, 2017 (as amended) against Advance Authorisation.

Before we move on to discuss how the concept of deemed export would work under GST let us understand the important supplies that are covered within the ambit of deemed exports under the above notification

Supplies against Advance Authorisations

Advance Authorisation ('AA') is issued under FTP to allow duty free import of inputs, which are physically incorporated in export product. Different types of AAs are issued under the FTP.

Let us take an example where the AA holder intends to procure any of the inputs covered by the AA indigenously instead of importing the same. In that case he can apply for issue of an Advance Release Order (ARO/ Letter of invalidation) for a particular input with specific quantity and value and to issue the same in the name of a particular manufacturer who is otherwise called as Intermediate goods manufacturer. Such a manufacturer of intermediate goods shall apply for an Intermediate Advance Authorisation to the DGFT. The supply that is made by the intermediate manufacturer to the original license holder is categorised as deemed exports

AAs issued prior to 1-7-2017

At the onset of GST there were a number of cases where exporters had based on export orders already applied and received AAs. However, the imports against these AAs were made on or after 1-7-2017 which suffered IGST.

21 Notification No. 48/2017-Central Tax, dated 18-10-2017

Recently, the Delhi High Court has issued an interim direction[22] permitting the petitioners to clear the consignments of imports constituting inputs for the fulfilment of export orders placed prior to 1st July, 2017 without any additional levies, and subject to the quantity and value as specified in the AA licences issued to it prior to 1st July, 2017

Supplies against Export Promotion Capital Goods (EPCG) Authorisations

The EPCG scheme is also a scheme introduced to incentivise exports. It allows import of capital goods subject to export obligation. It covers exporter of goods as well as service providers. Under the EPCG scheme the import duty is waived against export performance which is typically several times of the duty waived. As is the case in AA scheme the EPCG holder may export directly or through third parties. With the advent of GST all supplies were liable for payment of GST. With the concept of deemed export being notified the third party supplies for export by EPCG holder shall now be considered as deemed export and would get the benefits conferred in the case of deemed exports.

Supplies to Export Oriented Unit ('EOU')

EOU is a unit set up under the EOU Scheme. Some of the benefits extended to EOU's under the pre-GST regime include duty free procurements of inputs and capital goods. With the introduction of the GST this equation changed to the extent that supplies made to EOUs unlike to units in SEZ were not given the zero rating status. However, the EOU was allowed to claim refund of GST paid on inward supplies against their export supplies. This change led to huge working capital challenges for these units.

The supplies to EOUs is now notified[23] as deemed exports. It is important to note that for the purpose of Section 147 the following units as approved under Chapter 6 of the FTP 2015-20 would be covered within the term EOU:

- An Export Oriented Unit ('EOU')
- Electronic Hardware Technology Park ('EHTP') unit
- Software Technology Park ('STP') unit
- Bio-Technology Park unit

Specific procedure to be followed by EOUs for procurement of goods from DTA regarded as deemed exports

In respect of procurement by EOUs under deemed export notification a specific procedure has been prescribed[24]. The procedure is summarised hereunder:

a) Prior intimation in Form A (pre-approved by the Development Commissioner) to be given to the registered supplier and officers having jurisdiction over the supplier and the EOU

b) The Tax Invoice of the supplier to be endorsed for receipt of goods and copy of the endorsed Tax Invoice shall be sent to the registered supplier and officers having jurisdiction over the supplier and the EOU

c) The recipient EOU shall maintain records of receipt of deemed export supplies in Form – B in digital form and shall provide copy of the same to its jurisdictional officer on a monthly basis

Refund of tax in case of deemed exports

It may be noted that **deemed exports are not zero rated supplies** under Section 16 of the IGST Act and hence tax has to be paid by the supplier on these supplies. In terms of Explanation to Section 54 of the CGST Act "refund" *inter alia* includes **refund of tax** on supply of goods regarded as deemed exports. Hence, in case of deemed exports the refund is of **tax** and not of unutilised Input Tax Credit. This implies that a Tax invoice for deemed export supplies shall

22 Chemico Synthetics Limited And India Glycols Limited Versus Union of India & Others [2017 (10) TMI 225 (Del.)]

23 Notification No. 48/2017-Central Tax, dated 18-10-2017

24 Circular No. 14/2017-GST, dated 6-11-2017

be liable for payment of Tax. The amended Rule 89[25] of the CGST Rules, 2017 states that the refund of tax in respect of deemed exports can be claimed by –

a) The Recipient of the supply

b) The Supplier of deemed exports (where the recipient does not avail of input tax credit on such supplies and furnishes an undertaking to the effect that the supplier may claim the refund

The refund application is to be made in Form RFD-1. The relevant statements annexed to RFD-1 have been revised to cover deemed exports.

Nature of Levy in case of deemed exports

Deemed exports cannot be equated with exports. In that case what would be the nature of supply in case of deemed exports especially when the exporter and the supplier are located in the same State. The deeming of a supply as deemed export has a limited purpose benefiting the actual exporter to be relieved from the burden of tax charged by the supplier. Since the supply is not an export the nature of levy in case of deemed exports shall be governed by the normal provisions of Sections 7 and 8 of the IGST Act. In that case if the location of the supplier making a supply as deemed export and the recipient is in the same State the supply shall be intra-state supply liable for payment of CGST + SGST.

Accordingly, return rules amending Table 6A of GSTR-1 have been notified and columns for CGST and SGST are incorporated. **However, it is observed that corresponding changes are still not available on the GSTN portal. On the portal when "deemed exports" tab is selected by default IGST column appears.**

Merchant Exports

Under the pre-GST regime the merchant exporter procured the export goods against Form H free of sales tax and Central Excise he had the option of procuring duty free by following CT-1/ARE-1 route for exports. This ensured that the exporter's working capital did not get blocked in indirect taxes. However, under the GST regime the transaction of sale of goods between the supplier and the merchant exporter was a pure supply liable for payment of GST as far as the supplier is concerned. Section 16 provides the zero rating once the tax paid goods were exported by the merchant exporter. However, with refund procedures not being in place for a long time this amount to huge cash flow issues for these exporters. Mindful of the difficulties faced by exporters the much needed relief was proposed by the GST Council at its 22nd meeting whereby an option was provided to merchant exporters to procure goods at a concessional rate of 0.1% [0.05% CGST and 0.05% SGST or 0.1% IGST]. Accordingly, the scheme was notified[26] on 23-10-2017. The first question that comes to our mind is why even this nominal rate. Perhaps the reason may be to enable the Government to track the entire supply chain. However in the bargain to benefit the exporters the scheme has a negative impact of working capital issues for a person supplying to such exporters.

Important aspects/conditions of the scheme

Following important aspects regarding this concessional procurement option are enumerated hereunder:

a. The concession in rate of GST for procurement is prescribed as an exemption notification under section 6 of the IGST Act. However, since it does not exempt the entire tax on the supply such supplies shall not be regarded as an exempt supply under section 2(47) of the CGST Act

b. The exporter should be registered with an Export Promotion Council or a Commodity Board recognised by the Department of Commerce

25 Notification No. 47/2017-Central Tax, dated 18-10-2017

26 Notification No. 41/2017-Integrated Tax (Rate), dated 23-10-2017

c. The exporter needs to procure goods from a registered supplier under a Tax invoice

d. The goods should be exported within 90 days from the invoice date of the supplier

Procedural aspects of the scheme

a. The scheme is highly procedural and suppliers who make supplies at concessional rates to merchant exporters need to ensure that every condition in the notification is accurately fulfilled. The reason is although the scheme is show cased as a relief for the exporters it is actually an exemption granted to the supplier who supplies to an exporter. This is apparent from the last Para of the notification which reads as under:

> *"2. The **registered supplier** shall not be eligible for the above mentioned exemption if the registered recipient fails to export the said goods within a period of ninety days from the date of issue of tax invoice"*

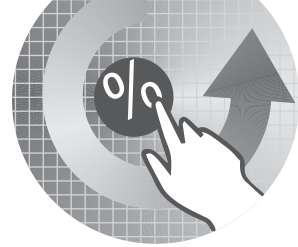
b. On going through the conditions and the procedures prescribed in the notification we realise that fulfilment of many of the conditions in the notification (like export within 90 days) are never within the control of the supplier. It is advisable that suitable indemnity clause safeguarding the interest of the supplier is incorporated in the terms of the contract with the merchant exporter for indemnifying the supplier in case any of the conditions are not fulfilled by the merchant exporter as a result of which the supplier loses the benefit of the exemption. As an alternative a detailed undertaking be obtained from the merchant exporter

Document/ Procedure	Steps to be followed by the Exporter/ Supplier	Compliance/ Comments
Purchase order	To be issued by the merchant exporter to the supplier for procurement at concessional rate	Copy of the PO to be sent to the officer having jurisdiction over the supplier
Supply of goods for export under a Tax Invoice	• Goods may move directly to the port/ ICD/ Airport or Land Customs Station for export, or; • To registered warehouse[27] from where they shall move to the port, etc.	In case the goods of multiple suppliers are aggregated in a registered warehouse by the exporter he shall: • Endorse receipt of goods on copy of the Tax invoice • Obtain an acknowledgement of receipt of goods from the warehouse operator • Copies of the endorsed Invoice and Acknowledgment be submitted to the supplier's officer
Filing of shipping bill and exporting the goods	• Exporter to ensure that the Tax Invoice No. and GSTIN of the supplier are mentioned on the Shipping bill against each item in the third party details column of the shipping bill • In case of multiple suppliers above details for each supplier should be captured in the shipping bill	• Copy of shipping bill and proof of EGM being filed be provided to the supplier and also to be submitted to the supplier's officer • It is clarified[28] that the exporter may exclude commercially sensitive information while providing copies of shipping bills to their suppliers

Forthcoming issues of the Chamber's Journal shall cover an in-depth analysis of export of services and the import side of the EXIM trade.

27 For the purpose of procurements at concessional GST rate it has been clarified *vide* Circular No. 42/2017-Customs, dated 7-11-2017 that a registered principal place of business or additional place of business shall be deemed to be "registered warehouse"

28 Para (2) of Circular 42/2017-Customs, dated 7-11-2017




CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

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

A. Central Goods & Services Tax (CGST)

1. Amendment to GST Rules- Thirteenth Amendment Rules (Notification No. 70 /2017 dated 21-12-2017)

Vide Notification No. 48/2017, supplies to specified persons were regarded as deemed exports. Accordingly, amendments have been carried out in GST rules which are as under:

– Changes in Table 6A of GSTR-1 [6(c)] so as to include transactions of deemed exports along with zero rated supplies;

– Suitable amendments have been carried out in Form GST RFD-01 & Form GST RFD 01A and Statement 5B is introduced in said forms so as to give effect of refund arising on account of deemed exports.

Further, amendments have been carried out in Form GST RFD-01 & Form GST RFD-01A and additional Statement 1A is prescribed in cases of refund arising on account of inverted duty structure.

2. Effective date of E-way bill (Notification No. 74/2017 dated 29-12-2017)

Vide the said notification, Government appoints 1st February, 2018 (all inter-state transactions) and 1st June, 2018 (for all transactions including intra-state) as the date from which the provisions of E-way bill will be made effective.

3. Amendment to GST Rules- Fourteenth Amendment Rules (Notification No. 75 /2017 dated 29-12-2017)

Several amendments have been made in the GST Rules. The significant ones are as under:

– Amendment to existing registration shall take effect from the date of submission of application in Form GST RFD-14;

– The definition of 'Net ITC' as prevailing under Rule 89 (refund of ITC in case of zero rated supply) is amended. The new definition of 'Net ITC' shall exclude the following:

  • ITC on account of 'deemed exports as per Notification 48/2017' (Since separate refund mode is prescribed for deemed exports)

  • ITC on account of 'merchant exports as per Notification

40/2017' (Since tax chargeable is only 0.1%);

– Rule 96 (Refund of IGST paid on exports) has been amended so as to include refund of IGST paid on export of 'services'.

Further, sub-rule 9 is added to Rule 96 which states that the person claiming refund of IGST paid on exports should not have received supplies on which supplier has availed benefit of 'deemed exports – Notification 48/2017' and 'merchant exports – Notification 40/2017';

– Several other procedural changes are made in Form GST REG-10, Form GST REG-13, Form GSTR-11, Form GST RFD-10, Form GST DRC-07.

B. CIRCULARS

1. Circular 22/ 2017 dated 21-12-2017 (Supplies by artist)

The said circular issues clarification regarding treatment of supply by an artist and supply of goods by artists from galleries. The circular clarifies the following:

– Art work for supply on approval basis can be moved from the place of business of the registered person (artist) to another place within the same State or to a place outside the State on a delivery challan along with the e-way bill wherever applicable and the invoice may be issued at the time of actual supply of art work

– Supplies of the art work from one State to another State will be inter-State supplies and attract integrated tax

– In case of supply by artists through galleries, there is no consideration flowing from the gallery to the artist when the art works are sent to the gallery for exhibition and therefore, the same is not a supply. It is only when the buyer selects a particular art work displayed at the gallery, that the actual supply takes place and applicable GST would be payable at the time of such supply.

2. Circular 23/2017 dated 21-12-2017 (Maintenance of books of account by principal or an auctioneer)

The said circular issues clarification in respect of maintenance of books of account relating to additional place of business by a principal or an auctioneer for the purpose of auction of tea, coffee, rubber etc.

– The principal and the auctioneer of tea, coffee, rubber etc. are required to declare warehouses where such goods are stored as their additional place of business. The buyer is also required to disclose such warehouse as his additional place of business;

– Both the principal and the auctioneer are required to maintain the books of account relating to each and every place of business in that place itself. However, they may maintain the books of account relating to the additional place of business at their principal place of business instead of such additional place;

– Such principal or auctioneer shall intimate their jurisdictional proper officer in writing about the maintenance of books of account relating to additional place of business at their principal place of business.

– Further, the principal or the auctioneer shall be eligible to avail input tax credit (ITC) subject to other provisions of the Act and the rules made thereunder.

Clarification has been issued regarding issues pertaining to movement of goods on supply on approval basis (for example jewellery). It is further clarified that all such supplies, where the supplier carries goods from one State to another and supplies them in a different State, will be inter-state supplies and attract IGST in terms of Section 5 of the IGST, 2017

3. Circular 24/ 2017 dated 21-12-2017 (Manual procedure of refund)

Due to the non-availability of the refund module on the common portal, manual process of refund has been prescribed in following cases:

- Refund claims on account of inverted duty structure
- Deemed exports
- Excess balance in electronic cash ledger

Clarifications and procedure regarding filing of above manual refund claims have been prescribed *vide* the said circular.

4. Circular 25/ 2017 dated 21-12-2017 (Clarification relating to advance ruling)

Since the requisite forms for filing of application for advance ruling is not available on common portal, the process of filing of manual application has been started and various clarifications are issued in this regard.

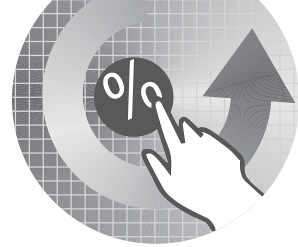
The form and manner of filing of manual application of Advance Ruling and application for filing of appeal to appellate authority has been prescribed *vide* the said circular.

5. Circular 26/ 2017 dated 29-12-2017 (Issues in Return filing)

Several clarifications are issued in relation to return filing under GST such as latest return filing calendar, applicability and quantum of late fees, amendment/correction/rectification of errors like under reporting of liability, changes in GSTR-1, etc.

6. Circular 42/2017 – Customs dated 7-11-2017

The facility of amending belated invoices in GSTR-1 i.e. in Table 9A (as clarified by Circular 42/2017) has been activated in the month of December. The taxpayers can now modify the invoices in Table 9A of GSTR-1.



CA Naresh Sheth

INDIRECT TAXES
GST – Recent Judgments

1. M/s. Kumar Traders and Company & Anr vs. The State of Assam & Others (2017-TIOL 29-HC-GUW-GST)

Facts, Issue involved and Contention of Petitioner

Petitioners has challenged the seizure of goods by the authorities of Bureau of Investigation for Economic Offences (BIEO) Officers consequent upon inspection, search and seizure of their godown by such authorities.

Contention of Respondent

The police team raided the godown in purported exercise of power u/s. 102 of Code of Criminal Procedure. BIEO team suspected that areca nuts stored in the godown, were of Burmese origin and were smuggled through Mizoram border and was stored in the Guwahati godown for onward transportation to other parts of the country.

Held

The stored areca nuts were neither stolen nor were kept in suspicious circumstances. At best, tax is payable for dealing in areca nuts but that would be in the domain of the Finance & Taxation Department. Submissions made by the Addl. Advocate General, Assam and the Asstt. Solicitor General of India reflect that BIEO team may have acted beyond their jurisdiction. The Govt. Advocate has prayed for and is granted three weeks' time to file counter affidavit.

In the interim, to facilitate petitioners to carry on their legitimate business and taking note of the fact that rate of tax is @2.5% for areca nuts under the Assam GST Act, 2017 and they are to pay further 2.5% tax to the Central Govt. coffer, subject to the petitioners' furnishing BG for ₹ 30 lakh towards the estimated tax to the Commissioner of State Tax, the seized goods should be released to the custody of the petitioners. The 7290 bags of areca nuts, after due verification should be released, in presence of the Tax Department Officials. However, the transportation and business of areca nuts will be subject to realisation of due tax by the authorities and the Bank guarantee, ordered to be deposited, is only an estimation and is not on quantification of the payable tax. The Finance & Taxation Department is at liberty to estimate the precise payable tax and make the assessment.

2. Iqra Roadways (India) and others vs. State of UP & Others (2017-TIOL-32-HC-ALL-GST)

Facts, Issue involved and Contention of Petitioner

Petitioners 1 & 4 are involved in transportation of goods from one place to another. The Petitioner No. 2 and 3 are the buyers and are registered under the Goods and Services Tax Act/Rules, 2017. The Petitioner No. 2 and 3 have affected certain purchases from different sellers situated at Delhi. According to petitioner no. 2 and 3 since they are duly registered under the Central Goods and Services Tax Act, 2017 and the goods purchased by them are duly accompanying with the requisite Tax Invoices, Bill as well as E-way Bill, the action of the respondent authorities in detaining and seizing the goods is bad. The vehicle has also been seized by the respondent No. 4 after detention of the goods. Since goods were in transport in the course of interstate trade, they do not come within the purview of State GST Act. The entire action of the respondent authorities is wholly illegal, arbitrary as well as without jurisdiction.

Contention of Respondent

The respondent claim that at the time of detention, the detaining authority has clearly mentioned in the detention memo that the necessary physical verification is required as the E-way Bill had expired and that on physical verification of the goods the authorities found certain irregularities. Since the goods were not accompanied with the requisite documents, it was liable to be seized and the requisite notice of such seizure was issued indicating therein the value of the goods and the demanded tax.

Held

Since the factual disputed issues are involved and penalty proceedings are already initiated, the seized goods be released in favour of the petitioners on the payment of ₹ 1,11,564/- (amount as indicated in the show cause notice dated 26-9-2017). Since the penalty of huge amount exceeding ₹ 6 lakhs is demanded, petitioner should approach the Appellate Authority and file an appeal. Appellate Authority is directed not to insist for deposit of any penalty amount for hearing and admission of appeal and appeal is to be disposed within 2 months from date of presentation of appeal.

3. M/s. Sameer Mat Industries & M/s. Kaleel Mat Industries vs. State of Kerala & Others (2017-TIOL-33-HC-KERALA-GST)

Facts, Issue involved and Contention of Petitioner

The goods were transported inter-State and neither CGST nor SGST was applicable to such goods. HSN Code as disclosed in the invoice is the one used by the manufacturer. The petitioner having purchased the goods from the manufacturer at Delhi could not change the HSN Code in which event there would be a violation of the provisions of the tax statutes. It is further contended that the E-way Bill uploading procedure as provided in the Rules to the CGST (which has been adopted under the IGST) is not implemented as of now. In the case of the inter-State transport, petitioner need to accompany the goods only with an invoice which has been done in the present case.

Contention of Respondent

It was found on verification that there was misclassification and also undervaluation. The goods were misclassified in invoice as falling under HSN Code 4601 (under which tax charged @18%) instead of HSN Code 3926 (under which tax charged @28%). The detention notice directed payment of CGST and SGST each @14% totalling 28% and the GST @5% for one other commodity as also a security deposit of an equal amount.

Held

Authorities appointed by the State have been empowered to implement the provisions which regulates the inter-State as also the intra-State trade. However the specific power invoked in issuing the impugned notice is under the CGST/SGST which is applicable only to the intra-state movement of goods. The issue of misclassification and undervaluation has to be gone into by the respective Assessing Officers and not by the Detaining Officer. The release of the goods was permitted on the execution of simple bond without sureties. Detaining Officer was directed to inform Assessing Officers of petitioner at Tamil Nadu.

4. M/s. Ramdev Trading Company & Another vs. State of U P and others (2017-TIOL-35-HC-ALL-GST)

Facts, Issue involved and Contention of Petitioner

The petitioner, a trader based in Rajasthan, claimed to have sold some quantity of 'Sweet Supari' and 'Refined Palm Oil' to a buyer located in Assam. The petitioner claimed to have charged IGST @ 18% and 5% respectively on the two items. These goods loaded on truck were passing through the State of U.P. being a transit State. Goods and truck were intercepted by the respondent No.4 at a place barely 15 kms from the border with the State of Bihar.

Petitioner stated that due to inadvertent mistake on part of truck driver, transit declaration form had not been downloaded and therefore, it was not found accompanying the goods.

Petitioner had replied to the show cause notice issued by the respondent alleging that Transit Declaration Form ('TDF") was absent and on physical verification different goods being found in place of 'Refined Palm Oil'. Respondent went ahead to impose penalty on the petitioner on the basis that:

- TDF was absent;
- Identity of the goods was different i.e. 'Ujala Shudh Deshi Ghee' was found in place of Refined Palm Oil; and
- Assessee had intention to evade payment of tax with the object of selling the goods inside the State of U.P.

The third allegation had not been alleged by the respondent previously in the show cause notice.

Contention of Respondent

It was noticed on verification of documents and detention of goods that goods were being transported without TDF required to be accompanied with such goods in accordance with Rule 138 of the U.P. GST Rule, 2017. Detaining authority was not satisfied as to the identity of the goods being same as that mentioned in the tax invoice with respect to the Palm Oil.

Further the respondents alleged that the assessee had intention to evade payment of tax with the object of selling the goods inside the State of U. P.

Held

The only allegation made in the seizure order was that the TDF was absent and that the goods were incorrectly described. There was no allegation regarding the petitioner's intention to evade tax. Besides such allegation was never made in the SCN. Further, the penalty order alleged intent of petitioner to sell the goods in UP so as to evade payment of tax.

However, the goods were never unloaded in UP. Petitioner was not asked to furnish any evidence in this regard therefore such allegation appeared to be an after-thought and in absence of any such allegations, the penalty is unsustainable. Moreover, the absence of TDF was a technical fault. The facts of the matter that the goods were not unloaded in UP were sufficient to prove that the goods were being sent to Assam from Rajasthan. Further, w.r.t. the misdeclaration of goods, the respondents should have let them pass with an endorsement, having appreciated that the State of UP was being used as a transit state. Seizure and penalty orders are unsustainable and set aside. The goods and vehicle be released and penalty set aside.

5. D. Pauls Travel & Tours Ltd. vs. Union of India & Anr. (2017-TIOL-37-HC-DEL-GST)

Facts, Issue involved and Contention of Petitioner

Petitioner is in the business of booking tours and hotel packages for customers and charges IGST from customers for bookings in hotels located outside Delhi. They are unable to avail input tax credit on the SGST charged by the hotels located outside Delhi since they are not registered in the State in question. Petitioner submits that as per the stand of the respondents, petitioner would have to be registered in all States and Union Territories to avail input tax credit of SGST which is contrary to the purpose and objective of Goods and Services Tax. The effective rates of tax would go up from 18% to 27% for hotel rooms in the ₹ 2,500/- to ₹ 7,500/- and from 28% to 42% for hotel rooms ₹ 7,500/- and above. Different provisions are applicable in case of online bookings through web travel portals and they are able to avail the credit.

Held

Respondents to examine the assertions and so called anomalies and inform the Court on the treatment accorded on sale of manufactured goods and other services which are provided by an assessee across the country. The respondents would also examine and consider whether the matter should be placed before the GST Council.

6. Hitesh Engineering vs. Union of India (2017-TIOL-40-HC-AHM-GST)

Facts, Issue involved and Contention of Petitioner

The petitioners have challenged the condition contained in clause (iv) of sub-section (3) of section 140 of the Central GST Act. The petitioners under earlier regime were the first stage dealers and importers of manufactured goods. With introduction of GST, the petitioners could avail CENVAT credit of the stock of goods provided purchases were made not earlier than one year. Petitioners have sizable stock of goods purchased prior to the said period and on which, by virtue of the said condition, no CENVAT credit would be available.

Held

Court issued the Notice, returnable on 25th January, 2018. As the legislation framed by the Parliament is under challenge, the Court directed to issue the Notice to the learned Attorney General also.

Note: The outcome in following cases were more or less similar:

i. *GMMCO Ltd. and Hafele India Pvt. Ltd. vs. Union of India & Anr. (2017-TIOL-42-HC-DEL-GST)*

ii. *Evergreen Seamless Pipes and Tubes Pvt. Ltd. vs. Union of India, through The Secretary Ministry of Finance, Dept. of Revenue, And Ors (2017-TIOL-44-HC-MUM GST)*

iii. *Lupin Ltd vs. Union of India & Ors. (2017-TIOL-45-DEL-GST)*

7. Coimbatore Road Contractors Welfare Association vs. Dr. C. Chandramouli, Commissioner of Commercial Taxes (2017-TIOL-41-HC-MAD-GST)

Facts, Issue involved and Contention of Petitioner

Petitioner made representations to the respondents stating that the contract works for which the agreements were executed prior to 1-7-2017, GST cannot be imposed as 2% VAT under the Tamil Nadu Value Added Tax, 2006 alone is applicable. The Writ Petition was disposed of by issuing directions to the Commissioner of Commercial Taxes to consider the representations given by petitioner and pass orders on merits and in accordance with law within a period of four weeks after hearing the petitioner. Aggrieved with the non-compliance of Court direction by Commissioner of Commercial Taxes, petitioner filed contempt petition.

Contention of Respondent

Respondent contended before the High Court that the Commissioner of Commercial Taxes had absolutely nothing to do in the matter and it is for the Central Government to have a say in the matter.

Held

The court took note of the G.O.Ms. No.264 dated 15-9-2017, and gave liberty to the Commissioner of Commercial Taxes to pass an order on merits and in accordance with law. If according to the Commissioner, he had nothing to do in the matter, nothing prevented him to contend so. In fact, that was an observation made by the Court in more than two places in the order.

Court would be fully justified in initiating action for contempt. However, considering the sensitivity of the matter and the members of the petitioner are put to hardship on account of the nebulous state of affairs, Court is inclined to give one more opportunity to the respondent to consider the representations given by the petitioner and pass orders on merits and in accordance with law within a period of two weeks.

8. Devashish Polymers Pvt. Ltd. vs. Union of India (2018-TIOL-03-HC-DEL-GST)

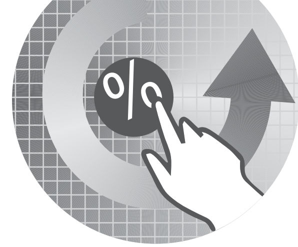
Facts, Issue involved and Contention of Petitioner

Petitioner submitted that if GST is levied on supply of goods lying in bonded warehouse, it would result in double payment of IGST. IGST @12% would be payable on import value of the goods of ₹ 100 plus basic customs duty when goods are released by petitioner from warehouse. Further, the petitioner would be liable to pay IGST on the entire sale consideration when goods are sold while in bonded warehouse. This would amount to double payment of IGST.

Held

Learned counsel for the respondents would obtain instructions on the said aspect and clarify the position in the counter affidavit. The matter will be relisted on 8th March, 2018. In case the petitioner succeeds, appropriate orders will be passed. Application for stay is disposed of with the aforesaid observations.

> Superstition is our great enemy, but bigotry is worse. If superstition enters, the brain is gone.
>
> — *Swami Vivekananda*



CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES

Service Tax – Case Law Update

Citation: 2017-TIOL-2629-HC-MUM-ST

Case: Commissioner of Central Excise, Nashik vs. MIDC (Maharashtra Industrial Development Corporation)

Background facts of the case

The Respondents "MIDC" is a corporation established by the Maharashtra State Government in exercise of powers u/s. 3(1) of the Maharashtra Industrial Development Act, 1961. MIDC was formed in order to perform the functions enlisted under MID Act, 1961 for securing orderly establishment of Industrial Areas and Industrial establishments & assisting in the rapid growth and development of industries in the State of Maharashtra.

MIDC besides receiving lease charges/ rentals from the plot holders towards the industrial plots leased out to them under the lease agreement at various industrial areas/ estates, also collects service charges from the plot holders for providing certain infrastructural facilities like roads, water, drainage, street light facilities etc. such as water charges, delay payment charges, service charges (for maintenance of street lights, roads, gardens, plantation, etc.).

The service charges so collected by MIDC are for the purpose of maintenance of roads, street lights etc., alleged by the Revenue, falls under the category of "Management, Maintenance or Repair Service."

Holding that the respondents are providing these services in accordance with MID Act 1961 and Rules framed thereunder, the activity undertaken by them is statutory function and therefore not liable to service tax, the Hon'ble Mumbai CESTAT set aside the demand on the respondents under the category of "Management, Maintenance or Repair Service."

Aggrieved by the above order, the appellants (revenue) were before the Hon'ble Mumbai High Court pleading to uphold the demand of service tax under the category of "Management, Maintenance or Repair Service" for the period October, 2011 to September, 2012, as substantial question of law arose since the Appellate tribunal proceeded on assumption that the service charges levied and collected by MIDC are for performance of statutory obligations and averted the findings of Additional Commissioner in the Order in Original.

Arguments put forth

The Appellants (Departmental Representative) submitted as under:

a) Management of immovable properties is covered by Section 65(64) of the Finance Act and that is how liability is incurred to pay service tax under the impugned category. As the respondents are not the owner of the plots and they are providing these services i.e., maintenance of roads, street lights, plantation to the owners of the plots therefore, their activity is squarely covered under Management and Maintenance and Repair service as the respondent is engaged in the activity of maintenance or management of immovable property.

b) Clarification issued by CBEC *vide* circular No. 89/7/2006 dated 18th December, 2006 that performing of mandatory and statutory functions by a statutory/public authority under the provisions of law does not come under the taxable service and therefore no service tax is leviable on such activity, shall not apply in this case as MIDC is not rendering statutory service to the allottees of industrial plots and hence squarely covered within the ambit of Management and Maintenance and Repair service. MIDC is not executing any sovereign function, as for its income and liabilities, the Maharashtra Government is not responsible. Therefore, it cannot be said that the respondent is performing sovereign function.

The Ld. Counsel for the Respondents assessee submitted as under:

a) MIDC acts as an agent on behalf the Government in performing its function under the MID Act.

b) MIDC is collecting service charges for provision of amenities such as roads, street lights, plantations etc.; pursuant to MID Act, Rules and the lease agreements. They are not providing maintenance/ repair services. In fact, the charges collected by them are towards the use of amenities and not for the maintenance and repair of roads, street lights, plantation etc.

Decision

a) Section 14 of the MID Act enlists the functions to be performed by the Corporations established u/s. 3(1) of the said Act, which provides for establishing and managing industrial estates besides general function of promoting & assisting in the rapid & orderly establishment, growth and development of industries in the State of Maharashtra. Section 2(a) of the said Act defines the term "amenity" which includes road, supply of water or electricity, street lighting, drainage etc.

b) Hon'ble Apex Court in the case of *Ramtanu Co-op. Hsg. Society Ltd. vs. State of Maharashtra* dealing with the constitutional validity of MID Act held that the functions and powers of the Corporation indicate that the Corporation is acting as a wing of the State Government in establishing industrial estates and developing industrial area. Also in case of *Haryana State Industrial Development Corporation vs. Hari Om Enterprises - 2009 (16) SCC 208,* Hon'ble Supreme Court held that considering the objects and purport for which the said Corporation of Haryana has been constituted, the function discharged by the Corporation must be held as Governmental function.

c) The function of the MIDC is not only to develop industrial areas but to establish and manage industrial estates as provided in Section 14 of MID Act. Therefore, it is the statutory obligation of the MIDC to provide amenities as defined in clause (a) of Section 2 of the MID Act to the industrial estates established by it. Thus, it is the statutory obligation of MIDC to provide and maintain amenities in its industrial estates such as roads, water supply, street lighting, drainage, etc. The service fees collected by MIDC are obviously in the nature of compulsory levy which is used by MIDC in discharging statutory obligations under Section 14.

d) There is no finding of fact recorded that the service rendered for which service tax was sought to be levied was not in the nature of statutory obligation. Revenue's appeal dismissed.

Citation: 2017-TIOL-4371- MUM CESTAT

Case: Zapak Digital Entertainment Ltd vs. Commissioner of Service Tax, Mumbai

Background facts of the case

The appellants M/s. Zapak Digital Entertainment Ltd. had taken credit of service tax paid for manpower recruitment and supply agency services availed from M/s. BVI HR Practice Pvt. Ltd. Upon investigation by the service tax department, it was found that the service providers have failed to discharge their obligation to deposit the service tax dues charged from their customers.

The adjudicating authority has allowed the claim of CENVAT. The department filed appeal against said Order in Original and CCE (Appeals) set aside the order. The CCE (Appeals) took note of the sample invoices of input services and relied upon the provisions under Rule 9(2) of CENVAT Credit Rules, 2004 that unless all the particulars as prescribed under the Central Excise Rules, 2002 or the Service Tax Rules, 1994, as the case may be, are contained in the document (invoice), CENVAT credit shall not be taken.

Arguments put forth

The Appellants submitted as under:

a) They have substantially complied with the provisions of CENVAT Credit Rules, 2004 and submitted that technical lapses, such as non-verification of the address of the service provider, in the invoice from the registration certificate of the provider, should not lead to demand of credit which was intended to prevent the cascading effect of the taxation.

b) Proviso to Rule 9(2) of the CENVAT Credit Rules, 2004 which provides "that if the document does not contain all the particulars but contains the details of duty or service tax payable, description of the goods or taxable service, assessable value, Central Excise or Service tax Registration number of the person issuing the invoice, as the case may be, name and address of the factory or warehouse or premises of first or second stage dealers or provider of taxable service, and the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, is satisfied that the goods or services covered by the said document have been received and accounted for in the books of the account of the receiver, he may allow the CENVAT credit; facilitate such situations of erroneous information in the documents against which credit is availed.

c) It is the responsibility of the service provider to discharge its tax obligation. Denial of the CENVAT credit on the ground of non-depositing of tax by the provider of the service is neither equitable nor necessary under law.

The Departmental Representative reiterated on:

a) The correctness of the findings of the first appellate authority with reference to the negligence in examining the invoice for discrepancies and the non-receipt of tax by the Government.

Decision

a) Hon'ble High Court of Allahabad in *Commissioner of Central Excise, Customs & Service Tax vs. Juhi Alloys Ltd.* held that when the assessee had received the inputs which were entered in the statutory records maintained by the assessee. The goods were demonstrated to have travelled to the premises of the assessee, it would be impractical to require the assessee to go behind the records maintained by the first stage dealer. CENVAT Credit cannot be denied when assessee was found to have duly acted with all reasonable diligence in its dealings with the first stage dealer.

b) Hon'ble Karnataka High Court in *Commissioner of Central Excise, Bangalore-I vs. Bhuwalka Alloys Pvt. Ltd.* held that there is no denial of the fact that the inputs which were produced by the appellant is duty paid and they were received and consumed by the assessee in the factory premises The assessee was required give all the particulars of the goods procured by them and the details of the duty paying document. There is also no finding that the inputs were not received in the factory premises or it was not used in the manufacturing process. In such situation, benefit of CENVAT credit cannot be denied to the dealer who has paid the duty.

c) In the instant case also, there is no dispute or any allegation that the assessee had not received services claimed to have been obtained or that payment inclusive of the service tax component had not been made in full.

d) The provider of the service failed to meet its statutory tax liabilities should not in any way impinge upon the entitlement of the assessee for CENVAT credit as has been clearly laid down in the decision of the Hon'ble High Court of Allahabad supra. Denial of CENVAT credit on the ground of failure to deposit tax by the service provider is not correct in equity when there is no any express condition to that effect of CENVAT Credit Rules, 2004.

Citation: 2017-TIOL-4322-CESTAT-MUM

Case: City Centre Mall Nashik Private Limited vs. Commissioner of Central Excise and Service Tax, Nashik

Background facts of the case

The Appellants were engaged in construction of a shopping mall which was rented out. During the course of construction the Appellants took CENVAT Credit in respect of the following items:

a) Cement, Steel, TMT Bars, Doors, Windows etc. used for construction of mall. The said items were considered as Inputs by the Appellants.

b) Capital goods used in the mall such as Lift, Escalator, Chillers, D.G. Sets, Heat Exchangers, Wires, Cables, Fire Fighting Equipment, Water Pumps, Transformers, Control Panels Distribution Boards, Cables, Trays, CRP Tubes etc. etc. for operation of mall.

c) CENVAT credit on various input services such as Architect Service, Business Auxiliary Service, C&F Agency Service, Consulting Engineer Service, Cargo Handling Service, etc. used for construction and operation of mall.

d) CENVAT Credit on various input services such as Advertisement Agency Service, Broadcasting Service, Chartered Accountant Service, Cleaning Service, Insurance Service etc. used before as well as after completion of construction of shopping mall.

The Order in Original denied the eligibility of CENVAT credit since all input and input service used for construction of shopping mall is for providing the service of construction and not for providing the service of renting of immovable property. As regards the Capital Goods, the Order in Original confirmed the demand stating that they resulted in immovable property after their installation. The total demand for ineligible CENVAT Credit was confirmed at ₹ 5,46,82,044/- and the period involved was March 2007 to March 2011.

The Order in Original also demanded service tax of ₹ 2,06,07,771/- towards utilisation of inadmissible CENVAT credit which includes CENVAT already demanded above.

Arguments put forth

The Appellant submitted as under:

a) CENVAT credit in respect of doors, windows, frames tiles, cement etc. used for construction of shopping mall are inputs which were used for construction of the shopping mall which was in turn used for providing the service of Renting of Immovable Property Service. Therefore the said inputs were used though indirectly but for providing output service.

b) As regard the CENVAT credit availed on the capital goods which was installed in the mall for renting of the shops in the mall. All these items falling under Chapter Headings 82, 84, 85 & 90, in terms of definition of capital goods and accordingly qualified as capital goods. These capital goods are independent equipment/ appliances which are not immovable but installed in the shopping mall.

c) As per the above definition of input service (for the relevant period) any services used for setting up of the premises of provider of output service is admissible input service hence credit is admissible.

The Learned Department Representative submitted as under:

a) All input and input service used for construction of shopping mall is for providing the service of construction and not for providing the service of renting of immovable property. Therefore the credit of input/input service used for construction is not admissible for CENVAT credit. This issue has been settled by the Larger Bench in the case of *Vandana Global Ltd. vs. Commissioner of C. Ex., Raipur 2010 (253) ELT 440 (Tri.-LB).* Accordingly CENVAT credit on goods such as cement steel, angles, channels etc. is not admissible.

b) As regard the CENVAT credit on capital goods it is submitted that while using such items in the shopping mall it is an immovable property, therefore credit is not admissible.

c) As regard the various services which is used such as industrial construction service, works contract service, architect, interior decorator, consulting engineer, erection, commissioning and installation etc. used prior to construction and after completion of the construction of shopping mall are not admissible as the same are not used for providing output service of renting of immovable property.

Decision

a) As regard CENVAT credit on the goods namely steel cement, doors, windows etc. used for construction of shopping mall, these goods were inputs for the service namely construction of shopping mall, however the same goods is not the input for providing output service i.e. renting of immovable property. Therefore in view of Hon'ble High Court of Bombay judgment in the case of *Bharti Airtel Ltd. vs. Commissioner of Central Excise, Pune-III 2014 (35) STR 865 (Bom.),* the CENVAT credit is not admissible on the goods used in the construction of mall. The larger bench of this Tribunal in the case of Vandana Global Ltd. (supra) also held that credit of goods used for construction of building/structure is not admissible

b) As regard the CENVAT credit availed on the capital goods, all the capital goods fall under the definition of capital goods provided under CENVAT Credit Rules 2004. The adjudicating authority denied the credit only on the ground that these capital goods after installation become immovable goods, therefore the credit is not admissible. It is observed that all the capital goods were cleared by the supplier on payment of duty therefore the capital goods as such cannot be said that it is immovable goods. Merely by installing the capital goods it does not become an immovable goods. If this contention of the adjudicating authority is accepted then all the capital goods such as machinery, equipment, appliances installed in the factory for production will not be eligible for CENVAT credit. All the capital goods were used in the shopping mall to facilitate the shop owners for operation of the mall, who have been given the shops on rent by the appellant.

c) As far as CENVAT credit on Input services are concerned, it is obvious from the definition of input services as it stood prior to 1-4-2011 and after 1-4-2011 that, in the earlier period there was no restriction on use of the input service for construction of building or civil structure used for providing output service. In the present case, we find that almost the entire credit has been availed on input services which have been used for providing the output service that is Renting of Immovable Property Service for which there was no restriction under the clause (i) of the definition of input service. The inclusive part of the definition of input service allowed services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service etc. The words setting up were deleted only from 1-4-2011. Therefore the appellants are eligible for the credit in terms of the definition of input service.

As regard demand of service tax amounting to ₹ 2,06,07,771/- this demand was confirmed on the ground that the service tax was paid to the extent of this amount by utilising the CENVAT credit which was held in admissible. It was held that once demand was of wrongly CENVAT credit is proposed, there cannot be another demand of recovery of service tax which was discharged by utilising so called wrongly availed credit.

Citation: 2017-TIOL-4268-CESTAT-MUM

Case: Pimpri Chinchwad Municipal Corporation vs. Commissioner of Central Excise, Pune I

Background facts of the case

The Appellants Pimpri Chinchwad Municipal Corporation (PCMC) are collecting certain fees/charges from various bidder (persons) for granting permission to use space on pavement/ footpath, road dividers, parks etc. for putting up billboards, kiosks etc. The show cause notice was issued wherein it was contended that these activities are taxable under the category of "Sale of space or time for advertisement service".

Accordingly, demand of service tax on such activity amounting to ₹ 1,17,95,397/- for the periods 2006-07 to 2010-11 was raised. The Adjudicating Authority confirmed the service tax liability as proposed in the show cause notice and also imposed penalty under Sections 76 and 78, demand of interest is also confirmed under Section 75.

Arguments put forth

The Appellant submitted as under:

a) PCMC is a Government corporation created under the Constitution. The appellant collecting money from various activities, it is part of the sovereign function of the corporation. In this regard reliance was placed on the Board Circular No. 96/7/2007-S.T. dated 23-8-2007 Point No. 999.01/23-8-2007.

b) It is further submitted that PCMC have two types of activity i.e. first – where the space is provided by the private owner of the property i.e. building, land etc. and PCMC charging fees, taxes etc., in this the property does not belong to the PCMC therefore it cannot be said that PCMC is providing space or time for display advertisement etc. In this category PCMC is charging statutory levy for which PCMC is authorised under the Constitution.

The Learned Departmental Representative stated that the services are squarely covered under the category of "Sale of space for advertisement service".

Decision

a) In a case where PCMC is charging fees/ taxes by giving permission for providing space by private parties to advertising agency is a statutory levy for which PCMC has got power from the provisions under the Constitution. Therefore such levies will not amount to provision of any service.

b) However, in case where PCMC is providing their own property such as land, building to the advertising agency for advertisement purpose, the activity gets clearly covered under the category of "Sale of space for advertisement". Therefore whatever space of land, building was provided by PCMC to the advertising agency, the amount recovered is liable for service tax.

Citation: 2017-TIOL-4276-CESTAT-MUM

Case: Commissioner of Service Tax, Mumbai VI vs. Gupshup Technology India Private Limited

Background facts of the case

The Respondents M/s. Gupshup Technology India Pvt. Ltd. is engaged in providing SMS Aggregator services to M/s. Facebook. The Respondent provides SMS Aggregator services to Facebook within India. They are engaged in activity of sending or receiving SMS to/from the Indian subscribers of Facebook by using a direct internet connection. The SMS Messages are sent to subscribers of Facebook. The bills were raised to M/s. Facebook, Ireland and the amount was received in convertible foreign currency. They filed refund applications towards refund of unutilized CENVAT credit of input services used for export of services in terms of Rule 5 of CENVAT Credit Rules, 2004 read with Notification No. 27/2012 – CE(NT) Dt. 18-6-2012.

The Respondent claimed that the services were exported to their client M/s. Facebook Ireland Limited. However, certain claims were rejected on the ground that the services provided by the Respondent to M/s. Facebook does not qualify as export of service. The Respondent filed appeals against the rejection of the claim whereas the revenue filed appeals against sanctioning of claims. The Appellate Commissioner allowed the appeals filed by the Respondent whereas the appeals of the revenue were rejected.

Arguments put forth

The Revenue submitted as under:

a) The Respondent provides SMS Aggregator services to Facebook within India. The SMS Messages are sent to subscribers of Facebook. The assessee provided the services in India on behalf of Facebook. Service is provided and consumed in India. Both the actual service provider and recipients of services are located in India.

b) It is a case of both the service provider and service recipient are located in India and accordingly as per Rule 3 of Place of Provision of Services Rules (POP), the place of provision of service is the location of service recipient of service. Proviso to Rule 3 of POP categorically states that where the location of the service recipient is not available in the ordinary course of business, the place of provision of service shall be the location of the recipient of the service. The contract is only to enable the assessee to provide services in India on behalf of Facebook. As per Rule 8 of POP, place of provision of service is the location of the recipient of the service where the service provider and service recipient are located in the same taxable territory. Therefore the transaction under consideration cannot be treated as export of services.

The Respondent submitted as under:

a) They are engaged in activity of sending or receiving SMS to/from the Indian subscribers of Facebook by using a direct internet connection between the Respondent and Facebook. They are carrying out the activities solely and principally and as per the express directions of Facebook for which they are paid entirely by Facebook. As per express clause they are in no way to deal with the persons to whom they send SMSs and their role is limited.

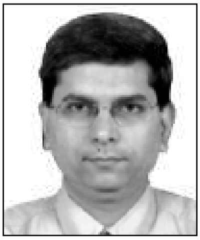
b) It is further submitted that proviso to rule 3 of Place of Provision of Service Rules, 2012 does not apply to present case as it categorically states that where the location of the service recipient is not available in the ordinary course of business, the place of provision shall be the location of the provider of service.. The business location of M/s. Facebook is Ireland which is available, hence the ground of appeal is not correct. The ground of the Revenue is that the subscribers of Facebook are recipient of service and both the service provider and service recipient are located in taxable territory and hence the provisions of Rule 8 of POP is applicable and therefore the services cannot be termed as export of services is also incorrect. The service provider i.e. the Respondent is located in India which is taxable territory and the service recipient i.e., M/s. Facebook is located in Ireland which is a non-taxable territory and therefore the provisions of Rule 8 would not apply

Decision

a) We find that the revenue has viewed the services as being provided in India on the ground that since the actual service recipient i.e. the subscribers whose SMSs are being sent or received are located in India and the Respondent is also located in India, hence it is not an Export of Service.

b) However, the services are provided under the terms and conditions of the agreement made between M/s. Facebook Ireland and the Respondent. The Respondent is not charging any service charges or part thereof from the Indian subscribers. The CBEC itself in its education guide Para 5.3.3 has clarified that the person who is obliged to make payment to the Service Provider is Service Recipient. In the present case it is not only the payment for services but even going further it is service agreement between the Respondent and M/s. Facebook Ireland which specifically provides for terms and conditions of services to be rendered under the instructions of M/s. Facebook. There is no contractual agreement between the subscribers of Facebook and Respondent. The fee is charged to Facebook. The Respondent has no control over the SMSs to be sent or received. The subscriber of Facebook are not even aware the existence of Respondent and the type of services rendered by the Respondent. Accordingly the recipient of service is Facebook, Ireland and the location of recipient shall be the place of provision of services.

c) It was also stated that if the revenue considered the services of Respondent as having not been rendered to outside taxable territory, it should have issued demand notice to the Respondent for service tax on bills raised by them to M/s Facebook. Having chosen not to do so, the revenue accepts that the services have been rendered to party situated outside India being falling under the category of "Export of Service" and it not taxable. Hence in such case the rejection of claim under consideration is not correct.



Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law No. 1

[2017] 205 Comp Cas 403 (NCLT)
[Before the National Company Law Tribunal – Principal Bench].
Axis Bank Ltd., In re
DBS Bank Ltd., vs. EDU Smart Services P. Ltd.

Unmatured claim like contingent liability, which is not crystallized at the time of commencement of the insolvency process cannot be accepted as debt. The mature claimed would be the one which are due on the date of admission of the petition.

Brief facts

The Axis Bank Ltd. ("Applicant") has granted various loans including working capital loans to Educom Solutions Ltd. ("Company"). Subsequently, the said loans were restructured by the Standard Chartered Bank and that SBICAP Trustee Co. Ltd. was appointed as the security Trustee for the said loans. As per the terms of Master restructuring agreement, loans granted to the Company including loan given by the applicant were secured by way of irrevocable and unconditional Corporate Guarantee by Edu Smart Services P. Ltd. ("Corporate Debtor").

DBS Bank Ltd. ("Financial Creditor") has made an application against the Corporate Debtor, which was admitted under Section 7 of the Code by the NCLT. The NCLT has admitted the petition issued a direction including the moratorium in terms of section 14 of the Code. The interim resolution professional ("IRP") has issued public notice inviting the claims. The applicant submitted its proof of claim in requisite form and supporting documents to IRP. The IRP *vide* its e-mail communication informed the applicant that the claim cannot be verified as the corporate guarantee had not been invoked and the liability of the Corporate Debtor is contingent in nature. After the IRP communication, applicant has invoked corporate guarantee in terms of an agreement and intimation to that effect has been given to SBICAP. Corporate Debtor has replied by stating that invocation of guarantee could not be accepted on account of CIRP and the moratorium.

The above facts was brought to the notice of IRP, who *vide* its letter communicated that claim could not be accepted and verified due to the following reasons:

1. That the liability under the corporate guarantee was contingent as on the date of commencement of insolvency process;
2. Applicant has not submitted fresh claim after the invocation of corporate guarantee;
3. Objection against invoking corporate guarantee in view of the existence of security trustee agreement;

In view of the above, applicant has filed an application under section 60(5) of the Insolvency and Bankruptcy Code, 2016 ("Code"). The application prayed for granting following relief by the Bench:

1. To set aside the IRP decision related to rejecting its claim for debt;
2. To direct IRP to accepts the applicant's claim as a financial creditor of the Corporate Debtor to the extent of the amount of debt on account of revocation of corporate guarantee.

The following submissions are made by IRP.

1. That applicant has already claimed the amount of debt against the Company in the corporate insolvency resolution process of said company pending before the NCLT, thus has suppressed the material facts.
2. Applicant should have made other financial creditor of the Corporate Debtor as party, since any alternation in claims would materially prejudice the rights of such creditors.
3. The applicant has made claim without recalling its loan or invoking or making demand on Corporate Debtor for corporate guarantee.
4. The total claim by the applicant is much more than the admitted secured creditors claim as well as assets of the Corporate Debtor thus, it seems a *mala fide* attempt to create hurdle in the CIRP.
5. Amount cannot be claimed simultaneously under the insolvency resolution process against the Company, which is a principal borrower and against the Corporate Debtor. If this two claims are accepted in two different CIRPs, then it would amount to unjust enrichment to such creditor.
6. Unmatured claim at the time of commencement of the insolvency process cannot be accepted. The mature claimed would be the one which are due on the date of admission of the petition. The reliance was placed on section 3(11) of the Code. In this case, the corporate guarantee has been invoked after the commencement of the insolvency process.
7. IRP would revive the amount of the claim already admitted and there is no provision for admitting any new claim.
8. The invocation of corporate guarantee against the corporate debtor is in violation of the moratorium imposed under section 14 of the Code.

The following submissions are made by the applicant.

1. The liability of the principal debtor and that of corporate guarantor is co-extensive as per section 128 of the Indian Contract Act, 1872.
2. The judgment of the Supreme Court in the case of *Central Bank of India vs. C. L.Vimla [2015] 7 SCC 337* and *State Bank of India vs. Saksaria Sugar Mills Ltd. [1986] 59 Comp Cas 861 (SC); AIR 1986 SC 868* are also referred.
3. Reference of various provisions of Code, Rules and Regulations and Judgments.
4. No material facts was suppressed and that it was not necessary to make disclosures with regards to claim made against the Company.
5. No such provisions of raising the assets and liability of the Corporate Debtor on the date of commencement of the insolvency process as claimed by the IRP.

Judgment

The Bench has dismissed the application. The following facts were noted:

1. On question of whether the applicant is entitled to make a claim by invoking corporate guarantee after the date of commencement of the insolvency process, bench has first looked at terms and conditions of the corporate guarantee executed. The said terms provides for invoking the guarantee by the security trustee/lenders upon default. The bench has also analyzed the provision of regulation 12 on Submission of proof of claims and regulation 13 on Verification of Claims by IRP. The combined reading of both the above regulations provides that (a) creditor has to submit proof of claim on or before the last date mentioned in the public announcement notice; (b) if, he fails, he can still submit the proof till the approval of a resolution plan by the committee of the creditors; (c) as per 13(1) of the Code, IRP has to verify the claims as on the date of commencement of insolvency process; (d) thus, to qualify as a "debt", corporate guarantee must have been invoked as per the terms of corporate guarantee and the date of such invocation should have been earlier than the commencement date, which is not the case here. Thus, IRP cannot verify the claims as same is not reflected in the books of account and in absence of such records, IRP cannot accept such claim.

2. To substantiate the above analysis, the definitions of "debt" "corporate debtor", "creditor" and "default" under various sections of the Code were also reviewed. The bench after making combined reading of all the above definitions, noted that a claim would mean a right to payment and also includes right to remedy for breach of contract under any law. Further, the expression payment and the debt, claim and the debt which is due from any person and includes financial debt and operational debt. Going by the above, debt is not due from the Corporate Debtor on the date of commencement of insolvency process. It became due only when the corporate guarantee was invoked by the applicant.

3. On applicant argument under section 128 of the Indian Contract Act as to invoking claim against principal borrower and on corporate guarantor, Bench is of the view that issue before the bench is whether debt was crystallized and was due and payable on the date of commencement of resolution process, which is already answered. It also observed that in equity also, the applicant would not suffer any prejudice as it has already claimed the amount in CIRP of the principal borrower.

4. Submission of the applicant that since section 22(3) of the Sick Industrial Companies (Special Provisions) Act, 1985 ("SICA") has been deliberately omitted from the Code and thus, it means no such bar on invocation of corporate guarantee by virtue of moratorium imposed under section 14 of the Code also rejected. The bench is of view that review of provisions of section 22(3) of the SICA and section 14 of the Code is not different in sum and substance.

> Those who work at a thing heart and soul not only achieve success in it but through their absorption in that they also realize the supreme truth – Brahman. Those who work at a thing with their whole heart receive help from God.
>
> — *Swami Vivekananda*

CS Kaushik Jhaveri

CORPORATE LAWS – RECENT DEVELOPMENTS

CONDONATION OF DELAY SCHEME, 2018

The Ministry of Corporate Affairs *vide* its notification dated 29th December, 2017 has introduced "Condonation of Delay Scheme, 2018" with a view to provide an opportunity to the non-compliant/ defaulting companies to rectify their defaults by 31st March, 2018.

Background and objective of the scheme

Consequent upon non-filing of financial statements and/or annual returns by companies with MCA for a continuous period of 3 financial years; MCA in September, 2017 had identified 309,614 directors to be disqualified u/s. 164(2) of Companies Act, 2013 consequently blocking their DIN.

Aggrieved by the stringent action, many disqualified directors made representations to MCA and approached the National Company Law Tribunal and High Courts for stay order of disqualification. Taking into consideration the representations made by various stakeholders, the Central Government and Ministry of Corporate Affairs introduced Condonation of Delay Scheme to provide a final opportunity for defaulting companies and Directors to regularize compliance before 31st March, 2018.

Effective Date

It shall come into force with effect from 1st January, 2018 and shall remain in force up to 31-3-2018.

Applicability of the Scheme

This scheme is applicable to all "defaulting companies" (other than the companies which have been struck off/whose names have been removed from the register of companies u/s. 248(5) of the Act). A defaulting company is permitted to file its "overdue documents" which were due for filing till 30-6-2017 in accordance with the provisions of this scheme.

In the event of defaulting companies whose names have been removed from the register of companies u/s. 248 of the Act and which have filed applications for revival u/s. 252

of the Act up to the date of this scheme, the director's DIN shall be reactivated only if NCLT issues the order of revival subject to the company having filed of all overdue documents.

Overdue Documents means – • Financial Statements or • Annual Returns or • Other associated documents, documents as mentioned in below list as applicable in the case of a defaulting Company OR
Defaulting Company – is the one that has not filed its – • Financial Statements, or • Annual Return As required under the Companies Act, 1956 or Companies Act, 2013, as the case may be, and the rules made there under for a continuous period of 3 years.

Eligible documents for purpose of filing under the scheme

Sr. No.	Form No.	Purpose of Filing
1	Form 20B/MGT-7	Annual Return by Company having Share Capital
2	Form 21A/MGT-7	Annual Return by Company not having Share Capital
3	Form 23AC, 23ACA, 23AC-XBRL, 23ACA-XBRL, AOC-4, AOC-4(CFS), AOC (XBRL) and AOC-4 (non-XBRL)	Form for filing of Balance Sheet/Financial Statement and Profit and Loss Account
4	Form 66	Compliance Certificate with ROC
5	Form 23B/ ADT-1	Intimation for appointment of Auditor

Steps to be followed for the purpose of the scheme

Temporary DIN Activation

a. Deactivated DINs of the disqualified directors at present shall be temporarily activated during the validity of the scheme to enable them to file the overdue document.

Filing of pending e-forms/ ROC documents

b. Defaulting companies shall file overdue documents in the respective prescribed E-forms paying the statutory filing fees and additional fee payable as per Section 403 of the Act read with Companies (Registration Offices and fees Rules, 2014 (Maximum additional being 12 times of actual fees).

Filing form e-CODS to seek condonation of delay

c. Defaulting company after filing documents under the scheme, shall seek condonation of delay by filing Form e-CODS 2018 along with a fee of ₹ 30,000/-. The e-form CODS 2018 will be made available from 20th February, 2018 or an alternate date, which will be intimated by MCA. Stakeholders need to complete the necessary procedural requirements and file overdue documents without waiting for the availability of the e-CODS form.

Effect of non-availing CODS, 2018

DIN of directors associated with defaulting company that have not complied with the following (or e-CODS) shall be liable to be deactivated on expiry of the scheme period–

a. Non-filing of overdue documents

b. Non-filing of e-form CODS 2018

c. Not having taken on record in the MCA-21 and/or

d. Are still found to be disqualified on the conclusion of scheme

In the event of defaulting companies whose names have been removed from the register of companies u/s. 248 of the Act and which have filed applications for revival u/s. 252 of the Act up to the date of this scheme, the Director's DIN shall be reactivated only on NCLT order of revival subject to the company having filed of all overdue documents.

The Registrar concerned shall withdraw the prosecution(s) pending if any before the concerned Court(s) for all documents filed under the scheme.

However, this scheme is without prejudice to action under section 167(2) of the Act or civil and criminal liabilities, if any, of such disqualified directors during the period they remained disqualified.

At the conclusion of the Scheme

- The Registrar shall take all necessary action under the Companies Act, 1956/2013 against the Companies who have not availed themselves of this scheme and continued in default in filing the overdue documents.

All concerned stakeholders are requested to avail benefit of this Condonation of Delay Scheme, 2018.

He who always thinks himself as weak will never become strong, but he who knows himself to be a lion, rushes out from the worlds meshes, as a lion from its cage.

— *Swami Vivekananda*

CA Mayur Nayak, CA Natwar Thakrar &
CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circular and notification issued by RBI :

1. Foreign Exchange Management (Transfer or Issue of security by a person resident outside India) Regulations, 2017

In supersession of the earlier Notification No. FEMA 20/2000-RB dated May 3, 2000, the Reserve Bank has issued Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 notified *vide* Notification No. FEMA 20(R)/ 2017-RB dated November 7, 2017.

2. Risk Management and Inter-Bank Dealings – Simplified hedging facility

The scheme of simplified hedging facility was first announced by the RBI in August 2016 and the draft scheme was released on April 12, 2017.

With a view to further simplify the process for hedging exchange rate risk by reducing documentation requirements, avoiding prescriptive stipulations regarding products, purpose and hedging flexibility, and to encourage a more dynamic and efficient hedging culture, RBI has amended the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No. FEMA 25/RB-2000 dated May 3, 2000) by insertion of new Regulation 5C which allows resident entities with foreign currency exposures and non-resident entities with rupee exposures, other than individuals, to hedge underlying exchange rate risk arising out of transactions permitted under Foreign Exchange Management Act, 1999, or rules or regulations or directions or orders made or issued thereunder, subject to such simplified terms and conditions as may be set forth in the directions issued by the Reserve Bank from time-to-time.

In exercise of these powers, RBI has issued guidelines of this facility which are given in Annex I to this circular and this facility will be effective from January 1, 2018.

[A.P. (DIR Series) Circular No. 11 dated 09th November, 2017 & Notification No. FEMA.388/2017-RB dated 24th October, 2017]

(Comments: This is a welcome move by RBI. This will reduce documentation process and help in ease of doing business. This facility is available to Resident and non-resident entities, other than individuals.)

3. Foreign Exchange Management (Transfer or issue of any Foreign Security) (Amendment) Regulations, 2017

In terms of Regulation 15, Para iii) of Notification No. 120 – **Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004,** an Indian Party, which has acquired foreign security is required to submit to Annual Performance Report (APR) and other reports and documents as may be stipulated by the RBI within 60 days from the date of expiry of the statutory period as prescribed by the respective laws of the host country for finalisation of the audited accounts of the JVs/WOs outside India.

Where the law of the host country did not mandatorily require auditing of the books of accounts of JV/WOS, the current regulation allowed submission of APR based on the unaudited annual accounts of the JV/WOS provided–

a. The Statutory Auditors of the Indian Party certify that 'the unaudited annual accounts of the JV/WOS reflect the true and fair picture of the affairs of the JV/ WOS' and

b. That the unaudited annual accounts of the JV/WOS have been adopted and ratified by the Board of the Indian Party.

RBI has now amended Regulation 15 as follows:-

(i) For the existing clause (a)
"The Statutory Auditors of the Indian Party certify that "The unaudited annual account of the JV/WOS reflect the true and fair picture of the affairs of the JV/ WOS".

the following has been substituted, namely;

"The Statutory Auditors of the Indian Party certify that law of the host country does not mandatorily require auditing of the books of accounts of JV/WOS and the figures in the APR are as per the unaudited accounts of the overseas JV / WOS".

(ii) After existing clause (b), the following shall be added, namely;
"(c) The above exemption from filing the APR based on unaudited balance sheet will not be available in respect of JV/ WOS in a country / jurisdiction which is either under the observation of the Financial Action Task Force (FATF) or in respect of which enhanced due diligence is recommended by FATF or the any other country / jurisdiction as prescribed by Reserve Bank of India."

[Notification No. FEMA.369/2017-RB dated 14th November, 2017]

(Comments: This is a welcome & practical move taken by RBI as it was difficult for the statutory auditors of the Indian Party to certify that accounts of the JV/WOS reflected true & fair view based on unaudited accounts.)

4. Investment by Foreign Portfolio Investors (FPI) in Government Securities Medium Term Framework

RBI has revised limits for FPI investments allowed under Schedule 5 to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 for the quarter Jan-March, 2018 as follows:

- The limits for investment by FPIs for the quarter January-March 2018 is increased by INR 64 billion in Central Government Securities (Central G-Secs) and INR 58 billion in State Development Loans (SDLs). The revised limits are allocated as per the modified framework prescribed in the RBI/2017-18/12 A.P. (Dir Series) Circular No.1 dated July 3, 2017, and given as under.

Limits for FPI investment in Government Securities							
							(₹ Billion)
	Central Government Securities			State Development Loans			Aggregate
	General	Long Term	Total	General	Long Term	Total	
Existing limits	1,897	603	2,500	300	93	393	2,893
Revised limits	1,913	651	2,564	315	136	451	3,015

- The revised limits will be effective from January 1, 2018.

[A.P. (DIR Series) Circular No. 14 dated 12th December, 2017]

(Comments:. This has given relaxation of investment limits to the FPIs, which will enable increased fund flow from FPIs to the economy.)

5. Master Direction on Compounding of Contraventions under FEMA, 1999

RBI has issued updated Master Direction on Compounding of Contraventions under FEMA, 1999, wherein changes have been made as under:

a) Para 3: Delegation of Powers to Regional Offices:
RBI has delegated Powers to regional officers

The compounding powers have been delegated to the Regional Offices of the Reserve Bank of India to compound the following contraventions of FEMA 20(R)/ 2017-RB:

FEMA Regulation	Brief Description of Contravention
Regulation 13.1(1)	Delay in reporting inward remittance received for issue of shares.
Regulation 13.1(2)	Delay in filing Form FC(GPR) after issue of shares
Regulation 13.1(3)	Delay in filing the Annual Return on Foreign Liabilities and Assets (FLA).
Paragraph 2 of Schedule I	Delay in issue of shares/refund of share application money beyond 60 days, mode of receipt of funds, etc
Regulation 11	Violation of pricing guidelines for issue/transfer of shares
Regulation 2(v) read with Regulation 5	Issue of ineligible instruments
Regulation 16 B	Issue of shares without approval of RBI or Government, wherever required
Regulation 13.1(4)	Delay in submission of form FC-TRS on transfer of shares from resident to non-resident or from non-resident to resident
Regulation 4	Receiving investment in India from non-resident or taking on record transfer of shares by investee company

b) **Para 5 : Application for Compounding**

Existing Para 5.3 *"Along with the application in the prescribed format, the applicant may also furnish the details as per Annex-II relating to Foreign Direct Investment, External Commercial Borrowings, Overseas Direct Investment and Branch Office / Liaison Office, as applicable, a copy of the Memorandum of Association and latest audited balance sheet along with an undertaking that they are not under any investigation of any agency such as Directorate of Enforcement, CBI etc. as per Annexure-III to complete the compounding process within the time frame".*

Following has been substituted, *"Along with the application in the prescribed format, the applicant may also furnish the details as per Annex-II relating to Foreign Direct Investment, External Commercial Borrowings, Overseas Direct Investment and Branch Office / Liaison Office, as applicable, a copy of the Memorandum of Association and latest audited balance sheet along with an undertaking* ***as per Annex III that they are not under any enquiry/investigation/adjudication by any agency such as Directorate of Enforcement, CBI etc. as on the date of the application and to inform to the Compounding Authority/RBI immediately, in writing, if any enquiry/investigation/adjudication proceedings are initiated by any agency against the applicant after the date of filing the compounding application but on or before the date of issuance of the compounding order to enable the Bank to complete the compounding process within the time frame".***

c) **Para 6: Pre-requisite for Compounding Process**

Existing Para 6.3 *"Cases of contravention, such as those having money laundering angle, national security concerns and/or involving serious infringements of the regulatory framework or where the contravenor fails to pay the sum".*

Following has been substituted, *"Cases of contravention, such as, those having serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity where the contravenor fails to pay the sum".*

d) **Insertion of new Paras 6.4 & 6.6 as follows:**

6.4 *In case where adjudication has been done by the Directorate of Enforcement and an appeal has been filed under section 17 or section 19 of FEMA, 1999, no contravention can be compounded in terms of Rule 11 of Foreign Exchange (Compounding Proceedings) Rules, 2000. The applicant shall confirm in the undertaking required to be furnished as per Annex III along with the compounding application that they have not filed any appeal under section 17 or section 19 of FEMA, 1999.*

6.6 *In terms of the proviso to Rule 8(2) of Foreign Exchange (Compounding Proceedings) Rules, 2000 inserted vide GOI notification dated February 20, 2017, if the Enforcement Directorate is of the view that the compounding proceeding relates to a serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity of the nation, the Compounding Authority shall not proceed with the matter and shall remit the case to the appropriate Adjudicating Authority for adjudicating contravention under section 13.*

Existing Para 6.4 has been renumbered as 6.5.

e) **Para 7.4 – (I) Guidance Note on Computation Matrix:** In Paragraph of Type of Contravention pertaining to Reporting Contravention, the variable amount has been reworded as under:

Above ₹ 10 lakhs & below ₹ 40 lakhs	₹ 2500 per year
₹ 40 lakhs or more and below ₹ 100 lakhs	₹ 7000 per year

f) **Para 7.4 – (I) Guidance Note on Computation Matrix:** In Paragraph of Type of Contravention pertaining to AAC/APR/Share certificate delays: Non submission/delay in submission of FLA Returns (FEMA 20 (R)), there is penalty of ₹ 10,000/- per return delayed.

g) **Para 7.4 – (I) Guidance Note on Computation Matrix :** In Paragraph of Type of Contravention pertaining to Residual type of contraventions to include all contraventions of FEMA 20(R)/2017-RB dated November 7, 2017.

h) **Newly inserted, general clause :** The contraventions of FEMA 20 existing and continuing as on November 07, 2017 (i.e., the starting date of contraventions prior to November 7, 2017) will be compounded as per 1(A) of the existing FEMA 20.

[Master Direction FED Master Direction No.4/2015-16 update as on 22nd December, 2017]

6. Master Direction on Reporting under Foreign Exchange Management Act, 1999

Since this Master Direction has been significantly amended, RBI has replaced the same rather than showing the changes in track mode for reader convenience on RBI website. RBI has listed changes at the end of Master Direction.

Certain changes were made *vide* Notification FEMA 20(R)/2017 dated 7-11-2017 and the effect of such notification has been incorporated in Master Direction as under:

a) PART IV – Foreign Investment in Reporting for issue of capital instruments.

Substituted as "Foreign Currency – Gross Provisional Return" instead "Foreign Collaboration - General Permission Route (FC- GPR)

b) Deleted with effect from Notification. Prior to deletion it read as "Non-compliance with the above provision would be reckoned as a contravention under FEMA and could attract penal provisions".

c) PART IV – Foreign Investment in Reporting of Annual return on Foreign Laibilities and Assets, it has been newly inserted.

For the existing Part IV under clause 1(c) *"All Indian companies which have received FDI and/or made FDI abroad in the previous year(s) including the current year, should file the annual return on Foreign Liabilities and Assets (FLA) in the Reserve Bank, Department of Statistics and Information Management, Mumbai by July 15 every year."*

Following has been substituted *"An Indian company which has received FDI or an LLP which has received investment by way of capital contribution in the previous year(s) including the current year, should submit form FLA to the Reserve Bank on or before the 15th day of July of each year."*

d) PART IV – Foreign Investment in Para 2 – Reporting for Transfer of Shares, newly inserted.

Following has been substituted

"Foreign Currency-Transfer of Shares (FC-TRS) (Annex IV):

1) Form FCTRS is required to be filed for transfer of capital instruments by way of sale in accordance with FEMA 20(R), between:

(i) A person resident outside India holding capital instruments in an Indian company on a repatriable basis and person resident outside India holding capital instruments on a non-repatriable basis; and

(ii) A person resident outside India holding capital instruments in an Indian company on a repatriable

basis and a person resident in India,

The onus of reporting is on the resident transferor/ transferee or the person resident outside India holding capital instruments on a non-repatriable basis, as the case may be.

For the existing

"Foreign Collaboration – Transfer of Shares (FC-TRS) (Annex IV): Reporting of transfer of eligible securities between residents and non-residents and vice-versa is to be made in Form FC-TRS. The Form FC-TRS should be submitted to the AD Category-I bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor/ transferee, resident in India. However, the onus of reporting the purchase of shares by non-residents on the recognized stock exchanges in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations is on the investee company. The bank should maintain the FC-TRS forms with it and should not forward the same to the Reserve Bank of India."

e) PART IV – Foreign Investment in Para 7(a) -Reporting requirement for Limited Liability Partnerships, deleted *vide Notification*

Prior to deletion it read as *"The report would be acknowledged by the Regional Office concerned, which would allot a Unique Identification Number (UIN) for the amount reported."*

f) PART IV – Foreign Investment in Para 7(a) – Reporting of Issue or Transfer of Convertible Notes-Form CN – *vide Notification*, substituted as *"30 days" Instead of "60 days"*

g) PART IV – Foreign Investment in Para 11 – Downstream Investment: An Indian entity making downstream investment in another Indian company or an LLP which is considered as indirect foreign investment for the investee entity in terms of FEMA 20(R), shall notify the DIPP within 30 days of such investment, newly inserted *vide Notification.*

[Master Direction FED Master Direction No.18/2015-16 update as on 20th December, 2017]

CA Jay Gosar & CA Gautam Shah

In Focus – Accounting and Auditing

First time implementation of Ind AS – Experience So Far

Introduction

Accounting Standards have been formulated with an objective to align different accounting policies followed by different organizations and practices to ensure comparability of the Financial Statements. The Accounting Standards are issued with a view to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view.

Until now, all the Indian companies followed the Accounting Standards which were based on the concept of Historical Cost, Prudence and Conservatism which is different from what most of other countries have been following. This resulted in lack of comparability of Indian Financial Statements at the international level. The multinational companies in India have the dual responsibility to prepare the financial statements of its Indian operation, one adhering to generally accepted accounting principles ('GAAP') of India and other as per the GAAP followed by the Parent Company. Hence, it was the need of the hour to harmonize the accounting principles globally and have a single set of accounting standards which are in line with International Financial Reporting Standards ('IFRS').

The process of issuing new set of accounting standards viz., Indian Accounting Standards ('Ind AS') had commenced way back in the year 2011. However, after facing various challenges, Ministry of Corporate Affairs (MCA) finally notified the roadmap for implementation of Ind AS on February 16, 2015. This ushered in the new version of accounting with introduction of various concepts such as Fair Valuation, Other Comprehensive Income ('OCI'), Expected Credit Loss ('ECL'), Emphasis on the Balance Sheet, etc. into Indian GAAP Framework.

India has chosen to move towards convergence with IFRS rather adopting IFRS straight away as it wanted to have these standards conducive to the Indian economic scenario as well as bring down the differences with IFRS to the minimum possible extent. The nomenclature for the naming and numbering of Ind AS is similar as that of international standards.

Introduction of these standards have surely brought in several changes in the preparation and presentation of the Financial Statement to ensure transparency, consistency, comparability, adequacy and reliability of the Financial Reporting.

Implementation in Snapshot

MCA has decided to implement Ind AS in a phased manner. This would probably be to follow step wise approach to enable smooth transition in each sector and ensure a seamless convergence.

a. **Corporates**

Types of Companies	Phase 1 Net worth INR 500 crore or more	Phase 2 Net worth less than INR 500 crore but up to INR 250 crore
Companies (including Holding, Subsidiary, JV, Associate Companies of such companies) whose equity or debt securities are: • Listed in India or outside • In the process of being listed	**Convergence Date:** April 1, 2016 **First Reporting (Entities listed in India)** Quarter ended June 30, 2016 **First Complete Financial Statement:** **Opening Period:** April 1, 2015 **Comparative Period:** March 31, 2016 **Reporting Period:** March 31, 2017	**Convergence Date:** April 01, 2017 **First Reporting (Entities listed in India)** Quarter ended June 30, 2017 **First Complete Financial Statement:** **Opening Period:** April 1, 2016 **Comparative Period:** March 31, 2017 **Reporting Period**: March 31, 2016
Companies (including Holding, Subsidiary, JV, Associate Companies of such companies) whose equity or debt securities are not listed viz., Unlisted Companies	**Convergence Date:** April 1, 2016 **First Reporting (Entities listed in India)** Quarter ended June 30, 2016 **First Complete Financial Statement:** **Opening Period:** April 1, 2015 **Comparative Period:** March 31, 2016 **Reporting Period:** March 31, 2017	**Convergence Date:** April 1, 2017 **First Reporting (Entities listed in India):** Quarter ended June 30, 2017 **First Complete Financial Statement:** **Opening Period:** April 1, 2016 **Comparative Period:** March 31, 2017 **Reporting Period:** March 31, 2016

b. Any Company including a Private Company can voluntarily implement Ind AS at any time but the same shall be irrevocable in future.

c. Companies listed or in the process of getting listed on SME Exchange have been excluded from the implementation of Ind AS.

d. MCA has issued separate roadmap for applicability of Ind AS to Banks, NBFCs. The date of convergence for these sectors has been set as April 1, 2018.

e. With respect to Insurance Companies, Insurance Regulatory and Development Authority of India (IRDA) has deferred the effective date for implementation of Ind AS in the insurance sector to April 2020 from April 2018.

First Time Reporting

For listed entities, Securities and Exchange Board of India (SEBI) *vide* its circular dated July 5, 2016 came forward with certain relaxation and clarifications on issues relating to first time implementation of Ind AS.

The summary of the circular is as follows:

SN	Particulars	Q1	Q2	Q3	Q4
A	Extension of timeline for filing quarterly results by one month viz., submission within 75 days of the end of the quarter	Y	Y	N	N
B	Providing QoQ and YTD Results of Comparative Period	Y*	Y*	Y**	Y
C	Providing Balance Sheet of Previous Period	NA	N	NA	Y
D	Providing Income Statement of Previous Period	Y^	Y^	Y^^	Y

Note:

*Limited Review/Audit shall be optional for Q1 and Q2;

**Limited Review/Audit shall be required Q3 onwards;

^Results of previous period is optional but if provided may not be subject to Limited Review/Audit

^Results of previous period is optional in Q3 but if provided shall be subject to Limited Review/Audit

In case the listed entity has subsidiaries/Joint Ventures/Associates, the entity may exercise the option to submit quarterly/year-to-date consolidated financial results in the second quarter instead of the first quarter of the financial year and this option shall not be changed during the remaining part of the financial year.

73 BSE companies across major sectors and majority of them being a part of BSE Top 100 Companies were chosen as samples to understand the SEBI relaxations accepted by such companies.

It was observed that while publishing their Q1 results, 15 companies (21%) availed the benefit of extension of timelines and submitted their first Ind AS compliant financial results beyond the original timeline. The picture changed drastically in Q2 results whereby this count reduced sharply to 3 companies (4%).

However, with respect to exemption of publishing the Ind AS results of the quarter and year ended as on March of the previous period, 35 companies (48%) availed the exemption in Q1 whereas 32 companies (44%) availed the exemption in Q2.

This tends to show that the listed corporates, be it Phase-1 or Phase-2 entities, are taking time to understand, adopt and implement Ind AS fully and are cautiously assessing the impact on the transition on its financial results of each quarter. However, many Ind AS are making its presence felt and the quarterly and yearly profit numbers of the previous period have changed significantly.

Many Ind AS may not have implemented since the impact may not be material, but significant disclosures of estimates and judgments would be required for the same. Hence, the complete initial impact of Ind AS on Indian Markets could be understood clearly only when all the companies covered under Phase-1 and Phase-2 shall publish their annual results along with the adequate disclosures and the detailed reconciliations of the financial numbers of comparative periods with those under previous GAAP.

Key Financial Impact of Ind AS

Implementation of Ind AS has resulted in significant GAAP adjustments impacting the companies at large. It was time consuming task to identify and quantify the GAAP adjustments and account for it in the Financial Results. Some of the key adjustments which were common across all the companies and have been the major reason for impact on net profit and net worth are discussed below.

1. Financial Instruments

As expected, Fair Valuation of Financial Instruments had material impact on the Financial Statements. Unlike under previous GAAP where financial instruments were accounted at historical cost, the same had now to be fair valued periodically. Based on the review of the Financial Statements of 73 BSE Companies as mentioned above, Fair Valuation of Investments, Fair Valuation of financial assets viz., Security Deposits and Loans using Effective Interest Rate (EIR) method, Impairment testing of Trade Receivables using ECL model, Fair Valuation of Derivative Instruments have been the primary reason for impact on the Financial Statements.

Classification of Compound Financial Instrument as Equity or Debt as per Ind AS 32 proved to be another challenging task primarily with respect to the convertible preference shares due to the numerous conditions for conversion attached to it. Fair valuation and accounting for the options embedded in these instruments proved to be very complex and confusing.

Also, undertaking fair valuation of equity instruments of unlisted entities as well as foreign entities was challenging since the base data could not be found easily and many valuation reports consisted of assumptions and caveats. With respect to investment in subsidiaries, joint ventures and associates, majority of the companies have opted to avail the benefit under Ind AS 101 and continued to value the investment at previous GAAP carrying value.

Evaluation of ECL Model primarily for Trade Receivables under General Approach posed as a challenge for many entities. Majority of the companies in the end chose to opt for Simplified Approach thereby undertaking collective assessment of its receivables under pre defined parameters and creating provision using provision matrix.

Ind AS 32, Ind AS 109 (Classification and Measurement of Financial Instruments) and Ind AS 107 (Disclosure Requirements of Financial Instruments) shall definitely have far reaching consequences in future.

2. Shares Based Payments

Another standard which had major impact on the Financial Statements is Ind AS 102, Share Based Payments. Under previous GAAP, there was no equivalent standard and the companies had been following the Guidance Note issued by Institute of

Chartered Accountants of India (ICAI) for accounting guidance. Under previous GAAP, the company could use either intrinsic value method or fair value method. However, Ind AS 102 only permits fair value method. This had significant impact on the companies who had been following intrinsic method earlier.

Accounting of share based payments in case of modification or cancellation of the plans or of group share based arrangements coupled with the extensive disclosures proved to be quite a challenge for the companies.

3. Business Combinations

Previous GAAP had no specific standards pertaining to Business Combinations except for minimum guidance received under AS 14 'Accounting for Amalgamations'. Under Ind AS 103, Business Combinations, all the assets and liabilities including the contingent liabilities and intangibles shall be accounted at fair value instead of book value. This shall have a significant impact on Goodwill/Capital Reserve which is recognized as the differential amount. Also, Ind AS 103 prohibits the amortization of goodwill and requires it to be tested for impairment annually. This had a huge impact on the numbers and has been a major adjustment item for all the companies which chose to account for every business combination retrospectively in accordance with Ind AS 103.

4. Property, Plant and Equipment (PPE)

Ind AS 16 had a mixed impact on the financial statements. Stores and spares satisfying the definition of PPE were capitalized instead of being charged to statement of profit and loss as required under previous GAAP. This had an impact on those capital-intensive manufacturing companies which had high usage and storage of such stores and spares. Another adjustment to the financial statement had been in the form of creation of Asset Restoration Obligation (ARO) being measured at its present value. Under previous GAAP, the concept of present value did not exist. Many companies especially those having a statutory obligation of creation of ARO had considerable impact. However, with respect to measurement of PPE, many companies preferred to choose Cost Model over Revaluation Model and continued to charge depreciation on the carrying value as per previous GAAP.

5. Revenue

Under Ind AS, the companies had to include in its revenue the gross inflow of economic benefit received and receivable by the entity on its account viz., Excise Duty and any amount collected on behalf of third parties are not the economic benefits to the entity needed to be excluded viz., Sales Tax, Service Tax and now Goods and Service Tax (GST). This resulted in grossing up of excise duty till quarter ended June 2017 and there onwards GST being reduced from revenue.

Ind AS required the revenue to be measured at the net value receivable by the company viz., at consideration net off all the discounts and commissions which are directly linked to the revenue like trade discounts, volume rebates, cash discounts and other incentives. Under previous GAAP, these costs were included in the advertisement and promotional expenses. This resulted in reduction in revenue but the overall impact being profit neutral.

6. Income Taxes

One standard which according to various companies has been challenging under previous GAAP as well as Ind AS is Accounting for Deferred Taxes or now Income Taxes. The concept of recognition of Deferred Taxes changed from Income Statement Approach under previous GAAP to Balance Sheet Approach under Ind AS. It also specifically required recognition of deferred tax liabilities on undistributed earnings of subsidiaries, associates, joint ventures subject to certain conditions. This has resulted in significant impact on the standalone as well as consolidated financial results.

7. Minimum Alternate Tax (MAT)

Introduction of Ind AS definitely led to initial ambiguity in the calculation of MAT since book profit based on Ind AS compliant financial statement have been different from the book profit based on previous GAAP. To bring in clarity on this matter, the Government introduced framework for convergence of MAT provisions to Ind AS profits and amended section 115JB of the Income-tax Act, 1961 accordingly. Key adjustments included:

– Clarity on the start point for calculation of MAT which shall be Total Comprehensive Income

– Fair Valuation Gain/Loss on all items designated at Fair Value through OCI to be considered at the time of disposal/ retirement

– Items which are reclassified from OCI to profit/loss at later stage shall be included at the time of such reclassification

Even though the clarification and amendment has been welcomed by everyone, clarity with regards to MAT shall be required at every stage in coming future since the companies have just taken the baby step in implementation of Ind AS and the companies will take its time to adjust with Ind AS fully.

Implementation of Ind AS – Challenging Task

If introduction of Ind AS was a challenge in itself, implementation had its own hurdles. Companies did face difficulties during the implementation process. Accounting has always been seen as a cost centre by majority of the companies. Introduction of Ind AS did dent the corporate pockets with additional costs in the form of consultation charges, valuation services, etc. However, if looked upon positively these hurdles can be considered as takeaways which are as follows:

1. Understanding the crux of the Standards

Every company which had no earlier experience of IFRS implementation or accounting under IFRS had faced challenges. The key reason for this was attributed towards the time taken to understand the actual intent of the standard and draw the correct map for implementation. Not so simple language, coupled with the terminologies and concepts being introduced for the first time posed as a major hurdle for many companies. Since Ind AS is a dynamic subject, most of the companies availed services of the consultants or recruit someone with knowledge and expertise of Ind AS for contention issues and ensuring due compliance especially in respect of disclosures.

2. Training the core execution team

Until March 2016, the core accounts and finance team of every company, which has implemented Ind AS currently, was acquainted with the preparation of the financial statements under previous GAAP. The historical cost concept of accounting was undergoing a major surgery giving birth to new concept of Fair Valuation, Substance over Legal Form, etc. Hence, it was very important to educate the patient about this surgery. However, replacing the old accounting concept fixed deep in the mind with the new ones was a time-consuming process as it took time for many to accept the same.

3. Need for an integrated ERP System

It has been seen that many companies have adopted Excel based approach for implementing Ind AS. The carve outs between previous GAAP and Ind AS were identified in the beginning. The Financial Statements/ Results were prepared based on previous GAAP concepts and the impact of the carveouts were adjusted manually in Excel. This practice is being followed for arriving at the final numbers of current as well as previous period. While this practice can be considered a stop gap arrangement, the same may not be sustainable in the long run. Every company will be required to redesign their accounting systems so that Ind AS compliant Financial Statements are generated with minimal manual interventions.

4. Indirect applicability of Ind AS on Insurance and NBFCs

Applicability of Ind AS on the Companies as well as to its Holding, Subsidiary, JV, Associate Companies proved to be tricky for many conglomerates having presence in different sectors especially Insurance and NBFCs. Consolidation of the financial statements shall require the financial statements to be prepared under same GAAP viz., Ind AS in current case.

However as mentioned earlier, Ind AS is applicable to Insurance companies from April 2020 and to NBFCs from April 2018. Hence, till then it shall become mandatory for such Insurance companies and NBFCs of such conglomerates to prepare dual financial statements viz., under previous GAAP for regulatory filings and under Ind AS for consolidation. This increased the work of the companies as well as the auditors.

5. Informing the impact of the convergence to the stakeholders

Phase-1 entities have experienced that Ind AS is not mere change in accounting policy but shall bring in significant business impact. While the actual impact of Ind AS will only be realized gradually, it shall be a challenge to educate and inform all the stakeholders about the impact of Ind AS on the financial performance. Though the detailed disclosures including the reconciliations with previous GAAP shall be useful, it shall be the responsibility of the company to justify each and every adjustment and impact in detail as and when asked by the stakeholders. Hence, the companies shall be required to understand Ind AS thoroughly with a logical reasoning rather than relying blindly on the consultants.

6. Convergence along with GST and ICDS

The timing of implementation of Ind AS could not be more challenging as the GST and Income Computation and Disclosure Standards (ICDS) under Income-tax Act, 1961 are also being served on the companies' platter at the same time. Given that the companies have no choice but to gobble everything at the same time, every company needs to be prudent and cautious at each stage. Every strategic decision will now require three-way analysis. Along with it if the financial accounting process is not properly integrated, there is possibility of financial statements being misleading and not depicting true and fair view of the business performance.

7. Long Journey for the Consultants

If Ind AS has been challenging for the companies, the consultants have also faced a daunting task in ensuring timely implementation. A great amount of efforts have been put in by the consultants to support, guide and educate the management of such companies. However, this implementation of Ind AS has not ended for the consultants as the new chapter begins from April 2018 in the form of Banks and

NBFCs and from April 2020 in the form of Insurance Companies. The journey ahead shall surely be complex, exciting and enriching but shall come up with lot of responsibility and expectations.

Conclusion

For any organization, Financial Statements help in communicating its financial position to its various stakeholders. With the introduction of various foreign trade and commercial policies at global level in an attempt to bring the world closer, introduction of Ind AS as a common set of financial reporting standards shall act as a catalyst in better understanding of the Indian Corporates' financial position globally.

The support from the regulators viz., MCA, SEBI and ICAI in the form of various FAQs, extension in timelines and formation of various committees and study sessions has to a greater extent facilitated the smooth transition process. While the Phase 2 entities did benefit from the lessons learnt by the Phase-1 entities during the implementation, the process has definitely not been an easy one with the companies facing challenges at every step.

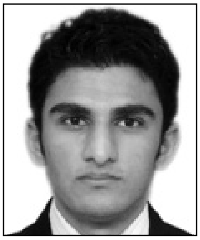
The only solution is to accept this challenge positively, be updated with technical knowledge and have patience to accept the overhaul in the economy since everything shall take time to settle. This activity shall not be an one-time exercise rather it shall be an ongoing process since the subjects are dynamic. Success of any new product lies in the efforts that have been put at the ground level to ensure that its quality meets the requirement. Similarly, the success of this transition shall depend on strong planning, creation and regular updation of the knowledge base, effective guidance and support at the execution level, continuous monitoring and review of the convergence process, timely implementation of corrective action plans, efficient use of technology and IT infrastructure and regularly informing the Board about the impact of the transition in the near and long run to assist them in decision making process. All these efforts shall pave a way for better corporate governance, increasing the confidence of the global stakeholders and ultimately resulting in better understanding and acceptance of financial reporting universe.

The powers of the mind should be concentrated and the mind turned | back upon itself; as the darkest places reveal their secrets before | the penetrating rays of the sun, so will the concentrated mind | penetrate its own innermost secrets.

—Swami Vivekananda

We are what our thoughts have made us; so take care about what you think. Words are secondary. Thoughts live; they travel far.

—Swami Vivekananda



Rahul Sarda, *Advocate*

BEST OF THE REST

1. Insolvency & Bankruptcy Code – Time for filing appeal – Appeal filed beyond 90 days – No jurisdiction to entertain appeal

The appellant preferred an appeal against the order dated 13-3-2017 passed by the National Company Law Tribunal, whereby and whereunder the application preferred by the appellant under sections 397, 398 and 402 of the Companies Act, 1956 (for oppression and mismanagement) had been rejected. Along with the appeal, the appellant had filed an application for condonation of delay. Section 421 of the Companies Act, 2013 prescribes the procedure to file an appeal against the orders passed by the Tribunal. Sub-section (3) therein prescribes the period of limitation and the power of the Appellate Tribunal to condone the delay up to 45 days. As per the said provision, the present appeal was to be filed within forty five days from the date of receipt of the order. In this case, order having been passed on 13-3-2017 and served on the same day, the appeal was required to be filed by 26-4-2017. However, it was not filed within the prescribed period and for the first time it was presented on 8-6-2017. The defect was pointed out on 12-6-2017 and after removal of defects, it was filed on 16-6-2017. From the Rule 26 of National Company Law Appellate Tribunal Rules, 2016, held, it was evident that only after rectification of the mistake a party is allowed to file an appeal. Thus, the date of filing of the appeal being 16-6-2017 which is beyond the further period of forty five days (total 90 days), held that the Appellate Tribunal had no jurisdiction to condone the delay.

P. Ram Bhoopal vs. Pragnya Riverbridge Developers Ltd. [2017] 87 taxmann.com 157 (NCLAT – New Delhi)

2. Prevention of Money Laundering Act, 2002 – Failure to explain source of demonetized currency – Application for bail liable to be rejected

Appellant-accused was arrested for offence u/ss. 3 & 4 of PML Act for depositing ₹ 38.53 Crore in cash of demonetised currency into bank accounts of companies and getting demand drafts issued in fictitious names with intention of getting them cancelled and thereby converting demonetised currency into monetised currency on commission basis. In appeal against rejection of bail of the appellant-accused, the Court observed that there was inexplicable silence or reluctance of appellant in disclosing source from where such huge value of demonetised currency and also new currency had been acquired by him. Fact that no limit for deposit was specified, in demonetisation in Notification dated 8-11-2016 would not extricate appellant from explaining source from where such huge amount had been acquired, possessed or used by him. Volume of demonetised currency recovered from office and residential premises of appellant, including bank drafts in favour of fictitious persons and also new currency notes for huge amount, leaves no manner of doubt that it was outcome of some process or activity connected with proceeds of crime projecting property as untainted property. Possession of such huge quantum of demonetised currency and new currency in form of ₹ 2000 notes, without disclosing source from where it is received and purpose for which it was received, appellant had failed to dispel legal presumption that he was involved in money-laundering and property was proceeds of crime. Therefore, held that the opinion of the Sessions Court and of the High Court in rejecting the prayer for grant of regular bail to the appellant-accused was not to be interfered with.

Rohit Tandon vs. Enforcement Directorate [2017] 86 taxmann.com 260 (SC)

3. Negotiable Instruments Act, 1881 – Mediation & Conciliation Rules would apply in a matter referred by Court concerned with a criminal case as well as proceedings under section 138 – Breach of undertaking – Contempt of Court

The appellant filed a complaint under section 138, complaining that the respondent had a liability of ₹ 55,99,600 towards her as recorded in a regular ledger account for supply of fire-fighting goods and equipment to the respondent on different dates and different quantities. In part discharge of this liability, the respondent had issued two account payee cheques in favour of the complainants of ₹ 11,00,000 and ₹ 16,00,000. However, these two cheques were dishonoured by the respondent's bank on presentation on account of 'insufficiency of funds'. After negotiations at the Delhi High Court Mediation and Conciliation Centre, the parties settled their disputes under a common settlement agreement under which the accused agreed to pay a total sum of ₹ 55,54,600 to the complainant as full and final settlement amount in instalments with regard to which a mutually agreed payment schedule was drawn up. It was undertaken that the complainant would withdraw the complaint cases after receipt of the entire amount. The accused/respondent herein failed to comply with the terms of the settlement. Though vested with the obligation thereunder to pay a sum of ₹ 11,00,000 as the first instalment, he paid only a sum of ₹ 5,00,000 to the complainant through RTGS without giving any justification.

Held, irrespective of and apart from the offences stipulated under section 320 of the Cr.P.C., section 147 makes the offence under section 138 specifically compoundable. Mediation and Conciliation Rules, 2004 stand notified by the High Court of Delhi which would guide the process to be followed even in references to mediation arising under section 138. Where proceedings are disposed on settlement terms by the High Court, it would be an order passed in exercise of jurisdiction under section 482 of the Cr.P.C. Upon breach of such order and non-payment of the agreed amounts, the same may be recoverable in terms of section 431 read with section 421 Cr.P.C. In addition, if the party has tendered an undertaking to abide by the terms of the agreement, which stands accepted by the Court, in the event of breach of the undertaking, action and consequences under the Contempt of Courts Act could also follow.

Dayawati vs. Yogesh Kumar Gosain [2017] 87 taxmann.com 128 (Delhi) (HC)


CA Ketan Vajani & CA Nishtha Pandya
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 7th December, 2017 to 7th January, 2018 are being reported as under.

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 22nd December, 2017.

Life Membership

1	Ms. Vora Bhakti Mayur	CA	Mumbai
2	Mr Rambhia Ronak Ashok	CA	Mumbai
3	Mr Rambhia Keyur Mahendra	CA	Mumbai
4	Mr. Agarwal Rajesh Maganlal	CA	Bilaspur
5	Mr. H. P. Bharath Prabhakara	Advocate	Bengaluru
6	Mr. Jaiswal Anand Kumar	CA	Bengaluru
7	Mr. Puri Hemant Premnath	CA	Mumbai

Ordinary Membership

1	Mr. Nawal Suyog Naresh (Half Yearly)	Advocate	Mumbai
2	Mr. Shah Dharmendra Bhogilal	CA	Mumbai
3	Mr. Ganeriwala Ram Karan (Half Yearly)	CA	Mumbai
4	Mr. Vedant Darshan Daulat	CA	Mumbai
5	Mr. Dundu Sashank Manmohan (Half Yearly)	Advocate	Mumbai
6	Mr. Gupta Piyush Pawan (Half Yearly)	CA	Gandhidham
7	Mr. Mamania Keval Mahesh	CA	Mumbai
8	Mr. Agarwal Pradeep Hariprasad (Half Yearly)	CA	Mumbai
9	Mr. Dhruva Rajesh Hasubhai	CA	Rajkot
10	Mr. Dhamecha Paresh Popatlal (Half Yearly)	CA	Mumbai
11	Ms. Shah Vrushali Kevalkumar (Half Yearly)	CA	Mumbai
12	Mr. Shah Girish Shivlal (Half Yearly)	CA	Mumbai
13	Mr. Doshi Pratik Surendra (Half Yearly)	CA	Mumbai
14	Mr. Thakker Anand Thakurdas	CA	Mumbai

II. PAST PROGRAMMES

1. ACCOUNTING & AUDITING / CORPORATE CONNECT COMMITTEE

Certificate Training Course on IND-AS was held on Saturdays, 16th & 23rd December, 2017 at Babubhai Chinai Committee Room, 2nd Floor, IMC, Mumbai – 400 020. The Course was addressed by CA Zubin Billimoria, CA Jayesh Gandhi, CA Hemal Shah, CA Khozema Anajwalla, CA Vypak Shrivastav & CA Yagnesh Desai.

2. INTERNATIONAL TAXATION COMMITTEE

Intensive Study Course on FEMA was held on 15th, 16th and 22nd December, 2017 at M. C. Ghia Hall, Kala Ghoda, Fort, Mumbai – 400 020. The Course was addressed by CA Dilip J. Thakkar, CA Manoj Shah, CA Hinesh Doshi, Mr. Moin Ladha, CA Anup Shah, CA Naresh Ajwani, CA Shabbir Motorwala, Ms. Harshita Srivastava, CA N. C. Hegde, CA Paresh P. Shah, CA Rajesh P. Shah, Mr. H. R. Khan - Former Deputy Governor of RBI and CA Hitesh Gajaria,

3. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

Full Day Seminar on Demonetisation Issues, Capital Gains, Benami Property & PMLA Act – Overview and Issues was held on 16th December, 2017 at ICAI Auditorium, Scheme No 74, Vijay Nagar, Indore. The Seminar was addressed by Mr. Vipul Joshi, Advocate, CA Mahendra Sanghvi, CA Jagdish Punjabi, CA Paresh P. Shah and CA Bhadresh Doshi.

II. FUTURE PROGRAMMES

1. INDIRECT TAX COMMITTEE

6th Residential Refresher Course on GST is scheduled to be held from 25th to 28th January, 2018 at The Ananta, Udaipur.

Workshop on GST Law jointly with BCAS, MCTC, GSTPAM, AIFTP (WZ) & WIRC OF ICAI is scheduled to be held from 17th January, 2018 to 14th March, 2018 at GSTPAM, Mazgaon Library, 1st Floor, 104, Vikrikar Bhavan, Mazgaon, Mumbai - 400 010

2. INTERNATIONAL TAXATION COMMITTEE

12th Residential Conference on International Taxation, 2017 is scheduled to be held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore

3. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

2nd Triangular Box Cricket Tournament Jointly with The Malad Chamber of Tax Consultants and The Goods and Services Tax Practitioner's Association of Maharashtra will be held on Saturday, 10th March, 2018.

4. RESIDENTIAL REFRESHER COURSE & SKILL DEVELOPMENT COMMITTEE

41st Residential Refresher Course is scheduled to be held from 22nd to 25th February, 2018 at Taj Swarna, Amritsar.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of December, 2017)

Direct Taxes Committee

Intensive Study Group Meeting on Recent important Decisions under Direct Taxes was held on 11th December, 2017 at CTC Conference Room

Mr. Fenil Bhatt, Advocate addressing the participants

Intensive Study Group Meeting on Recent important Decisions under Direct Taxes was held on 5th January, 2018 at CTC Conference Room

CA Viraj Mehta addressing the participants

Accounting & Auditing Committee

Study Circle on Ind AS 12 – Income Taxes was held on 13th December, 2017 at CTC Conference Room

CA Pankaj Tiwari addressing the participants

Allied Laws Committee

Study Circle on Disqualification of Directors – Remedies was held on 20th December, 2017 at SNDT Committee Room

Ms. Prachi Manekar, Advocate addressing the participants

International Taxation Committee jointly with Study Circle and Study Group Committee

Intensive Study Group on CBCR / Master File Indian perspective & recent decisions on International Tax was held on 21st December, 2017 at CTC Conference Room

CA Ronak Doshi addressing the participants

Indirect Taxes Committee

Webinar on Exemption under GST was held on 8th December, 2017

CA Jinit Shah addressing the participants

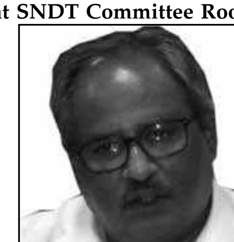
Study Circle on Issues in Input Tax Credit in GST was held on 12th December, 2017 at SNDT Committee Room

Mr. M. H. Patil, Advocate (Chairman) addressing the participants

CA Hemang Shah (Group Leader) addressing the participants

Study Circle and Study Group Committee

Study Group on Recent Judgments under Direct Taxes was held on 14th December, 2017 at SNDT Committee Room



Mr. K. Gopal, Advocate addressing the participants

International Taxation Committee

Intensive Study Course on FEMA was held on 15th, 16th, and 22nd December, 2017 at Terrace Hall, West End Hotel, Churchgate

DAY 1

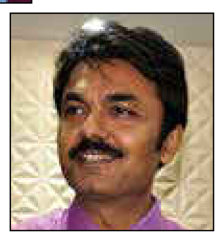
Mr. Ajay R. Singh, Advocate (President) giving opening remarks. Seen from L to R: CA Rajesh P. Shah (Chairman), CA Dilip J. Thakkar, CA Hinesh Doshi (Vice-President) and CA Rajesh L. Shah (Co-Chairman)

CA Rajesh P. Shah (Chairman) welcoming the speakers

CA Dilip J. Thakkar inaugurating the session. Seen from L to R: CA Rajesh P. Shah (Chairman), Mr. Ajay R. Singh, Advocate (President), CA Hinesh Doshi (Vice-President), CA Rajesh L. Shah (Co-Chairman) and CA Manoj Shah (Past President and Speaker)

CA Dilip J. Thakkar giving inaugural and keynote address

Faculties

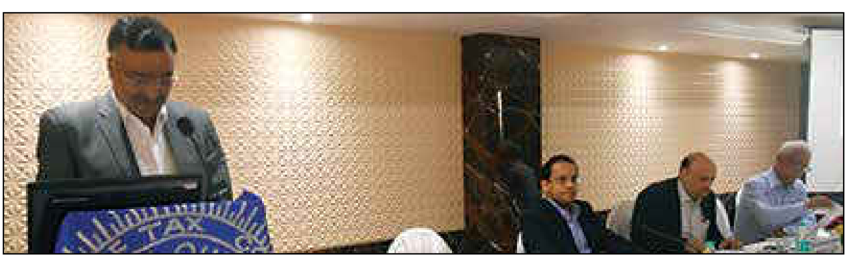


CA Manoj Shah

CA Hinesh Doshi

Mr. Moin Ladha, Advocate

DAY 2



CA Vijay Gupta (Vice-Chairman – Delhi Chapter) welcoming the speakers. Seen from L to R: CA Anup Shah (Speaker), CA Hinesh Doshi (Vice-President) and CA Rakesh Upadhyay (Convenor)

Faculties

CA Anup Shah

CA Naresh Ajwani

CA Shabbir Motorwala

Ms. Harshita Srivastava, Advocate

International Taxation Committee

Intensive Study Course on FEMA was held on 15th, 16th, and 22nd December, 2017 at Terrace Hall, West End Hotel, Churchgate

DAY 3

Faculties


CA N. C. Hegde


CA Rajesh P. Shah


CA Paresh P. Shah


Panel Discussion. Seen from L to R: Shri H. N. Khan – Former Dy. Governor of RBI, CA Dilip J. Thakkar - Moderator and CA Hitesh Gajaria

Accounting & Auditing Committee

Certificate Training Course on Ind-AS was held on 9th, 16th and 23rd December, 2017 at Babubhai Chinai Committee Room, IMC, Churchgate

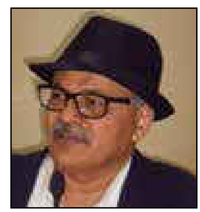
Faculties


CA Khozema Anajwalla


CA Vyapak Srivastava


CA Jayesh Gandhi


CA Hemal Shah


CA Yagnesh Desai


CA Zubin Billimoria

Panel Discussion – Seen from L to R: CA Khozema Anajwalla, CA Jayesh Gandhi, CA Yagnesh Desai and CA Zubin Billimoria

CTC Staff Lunch on Meeting was held on 4th January, 2018

IT Connect Committee

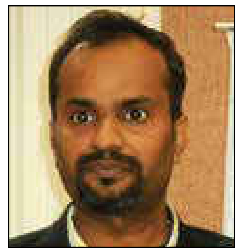
Impact of Technology on Audit Function: Blockchain & Data Analytics was held on 5th January, 2018 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate

CA Parag Ved (Hon. Treasurer) giving opening remarks

CA Dinesh Tejwani (Chairman) welcoming the speakers

Faculties

Mr. Jairam Rajshekhar, Director Sama Audit Systems



Mr. Prasanna Lohar, Head – Innovation, DCB Bank

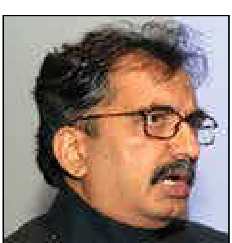
Membership & Public Relations Committee

Full Day Seminar on Demonetisation Issues, Capital Gains, Benami Property and Penalty u/s. 270A jointly with Tax Practitioners Association, Indore was held on 16th December, 2017 at ICAI Auditorium, Indore

Inaugural Session – Seen from L to R: CA Manoj Gupta (Vice-President, Tax Practitioners Association, Raipur), Mr. Ajay R. Singh, Advocate (President, CTC), CA Rajesh Joshi (Secretary, Tax Practitioners Association, Raipur) and CA Vikram Gupte (President, Tax Practitioners Association, Raipur)

Mr. Ajay R. Singh, Advocate (President) giving his opening remarks

Faculties



Mr. Vipul Joshi, Advocate

CA Mahendra Sanghvi

CA Jagdish Punjabi

CA Paresh P. Shah

CA Bhadresh Doshi

Membership & Public Relations Committee

Full Day Seminar on Demonetisation Issues, Capital Gains, Benami Property and Penalty u/s 270A jointly with Tax Practitioners Association, Indore was held on 16th December, 2017 at ICAI Auditorium, Scheme No 74, Vijay Nagar, Indore

Group Photo

Press Release of Indore Event in Nayi Duniya and Dainik Bhaskar on 17-12-2017

सेमिनार में मुंबई के टैक्स कंसल्टेंट ने टैक्स प्रैक्टिशनर्स व वकीलों को समझाए कानून

गाइड लाइन से कम कीमत पर संपत्ति खरीदी तो अंतर पर चुकाना पड़ेगा इनकम टैक्स

सेमिनार | नोटबंदी, बेनामी एक्ट, टैक्स असेसमेंट पर आदि पर टीपीए के कार्यक्रम में विशेषज्ञों ने दी जानकारी

पत्नी के नाम निवेश, शेयर और संपत्ति है तो बता दें छापे में वह नहीं बता सकी तो मानी जाएगी बेनामी

Membership & Public Relations Committee

Full Day Seminar on Demonetisation Issues, Capital Gains, Benami Property & PMLA's Act – Overview & Issues (Jointly with Raipur Branch of ICAI) was held on 6th January, 2018 at Vrindavan Hall, Civil Lines, Raipur

Group Photo of Office Bearers of CTC, Raipur Branch CICR of ICAI and Speakers


Mr. Ajay R. Singh, Advocate (President - CTC) giving his opening remarks

Press Release of Raipur Event in Nav Bharat Times on 7-1-2018

सीए का काम केवल टैक्स कानून समझना नहीं, उनकी जांच करना भी है

फोटो: नवभारत

■ नवभारत रिपोर्टर । रायपुर

सीए ब्रांच रायपुर, इनकम टैक्स बार व चेम्बर ऑफ टैक्स कंसलटेंट मुम्बई के तत्वाधान में ऑपरेशन क्लीन इंडिया कार्यक्रम का भव्य आयोजन किया गया.

रायपुर सीए ब्रांच के अध्यक्ष सीए अमित चिमनानी ने अपने वक्तव्य में कहा कि यह समय बदलाव का है. सरकार हर लेन-देन पर पैनी नजर बनाए हुए है इसलिये ईमानदारी से व्यापार करना अपने व देशहित में होगा. बदलते समय को देखते हुए व्यापार करने के तरीके भी बदलने होंगे. इनकम टैक्स बार के अध्यक्ष विजय मालू ने बेनामी संपत्ति कानून व नोटबंदी के प्रभावों के बारे में विस्तृत जानकारी दी. मुम्बई से आए [illegible]

कार्यक्रम में नोटबंदी के दौरान पकड़ी गई ब्लैक मनी के असेसमेंट, किसी अन्य व्यक्ति के नाम से ली गई सम्पत्ति के जब्ती कानून, जमीनों व अन्य असेट्स पर लगने वाले कैपिटल गेन व मनी लान्ड्रिंग के प्रावधानों पर भी विस्तृत चर्चा की. इस दौरान मुम्बई से अनीश ठक्कर, जगदीश पंजाबी, हिमेश दोषी, अभितान मेहता, परेश शाह ने भी जानकारियां साझा करते हुए कहा कि अब सभी विभाग सूचनाओं को एक-दूसरे से आदान-प्रदान कर रहे हैं. अब जो लोग हर जगह अलग जानकारियां देते हैं, उन्हें जल्द ही पकड़ा जा सकेगा. बेनामी संपत्ति कानून के तहत अब नोटिस जारी होने लगे हैं और जिन लोगों ने अपने पैसों से किसी और के नाम से संपत्ति खरीदी है या अपनी अनअकाउंटेड मनी के [illegible]

Dignitaries on dais. Seen from L to R: CA Kishor Baradia (Secretary Raipur Branch of ICAI), CA Anish Thacker (Speaker), CA Amit Chimnani (Chairman Raipur Branch of ICAI), Mr. Ajay R. Singh, Advocate (President - CTC), CA Jagdish Punjabi (Speaker) and CA Sunil Agrawal (Vice-President, I.T. Bar Raipur)

Half Day Seminar on Analysis of The Judgment of Hon'ble Delhi High Court on Implementation of ICDS was held on 10th December, 2017 at Symbiosis (IELTS), Pune

Dignitaries on dais. Seen from L to R: CA Abhitan Mehta (Speaker), Mr. Ajay R. Singh, Advocate (President) and Mr. Sharad Shah


CA Abhitan Mehta addressing the participants

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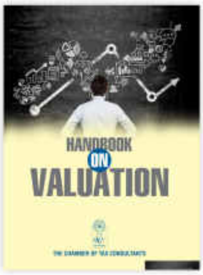

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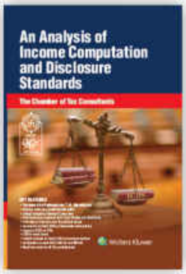

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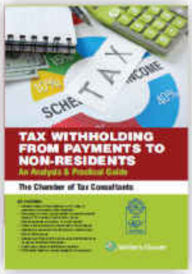

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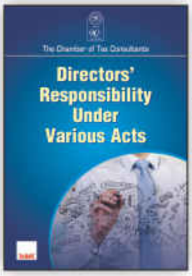

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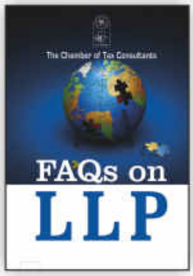

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