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Estd. 1926

92nd Year

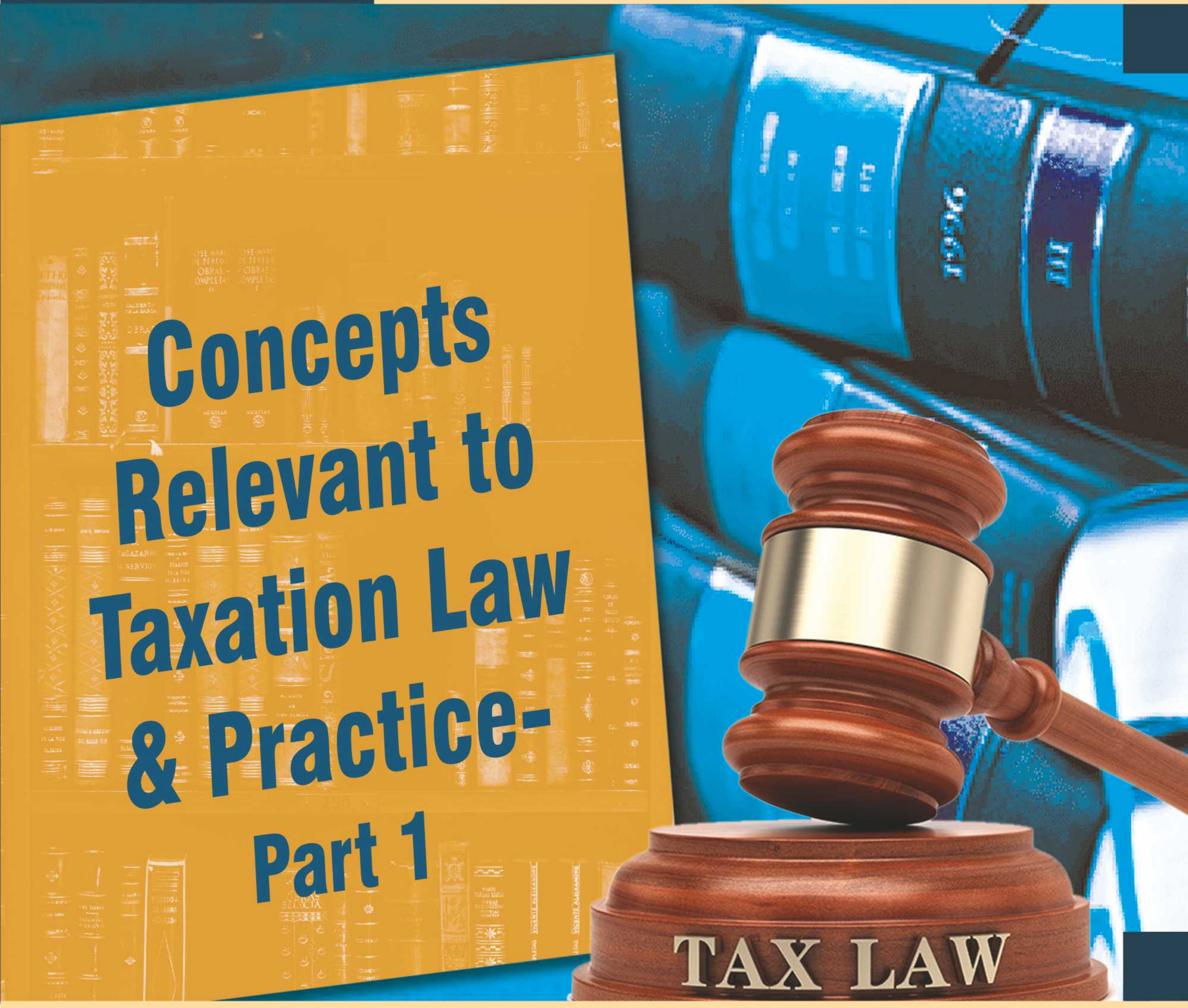
ज्ञानं परमं बलम्

A Monthly Journal of

The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS



Concepts Relevant to Taxation Law & Practice- Part 1

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The Chamber's Journal

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Editorial

The Hon'ble Finance Minister Mr. Piyush Goyal has presented the interim budget in place of vote on account which is done usually in an election year. Those critical of the Government's move to present an interim budget term it as unconstitutional and unethical practice. Anyway, we are not getting embroiled in this controversy. But this step of the Hon'ble Finance Minister has put me and the Journal Committee in a difficult spot. As you all are aware, we cover the Finance Bill in a special story. However, this year looking at the practice we didn't plan to bring a special story on the Finance Bill, 2019, as we presumed vote on account presented by the Hon'ble Finance Minister may not have any major announcements. Contrary to our belief, there are several amendments made to the Income-tax Act, 1961 which are far reaching and important. Thus, we have covered the Finance Bill in a special article and split the special story for this month in two parts.

The Journal Committee with lot of effort has put together a special story on "Concepts Relevant to Taxation Law and Practices". Now this special story will come in Part 1 & 2. Eminent professionals have contributed on major concepts of taxation. As mentioned earlier, the Hon'ble Finance Minister has made substantial changes which will have an impact on an ever expanding middle class in our country. We welcome these amendments. However, it is difficult to hold myself back from suggesting that he should not go only by the proposals made by the bureaucrats, but, he should consider the suggestions made by the professionals also. Had he done this he would not have wasted his time and energy in amending two sections to grant relief with respect to taxing notional income under the provisions of House Property. It may not be out of place to mention that after protest from all stakeholders, the tax on the notional income under the head 'Income from House Property" was not provided in Direct Tax Code, 2010. We presume that Hon'ble Finance Minister is too tight pressed for time. However, we professionals are always there to help him to achieve mitigation of difficulties and hardships faced by the taxpayers. The proposed amendment to Section 54 of the Act extending benefits of investment in two residential houses once in a lifetime is definitely a welcome move and will give much needed relief to assessees. Further proposals regarding quick processing of returns, granting of refunds and electronic assessments through anonymised back office without any personal interface between assessees and tax officers are really appreciable. It will surely go a long way to eradicate corruption.

I thank all the professionals for contributing to the February, 2019 issue of The Chambers Journal.

K. GOPAL
Editor

v

From the President

لا يمكنك تغيير الماضي حتى
تركز على صنع مستقبل عظيم

Is an Arabic quote which says – "We can't change the past, so let's focus on making a great future!"

Dear Members,

So often, we focus and stay so much in the past when we are all aware with the fact that it is something that cannot be changed! Instead, imagine how fruitful it would be if we would pivot our entire puissance towards the future. Maybe, the world today requires more of that than hovering over the past. Uncountable global issues would get resolved if the human race considers it more imminent to focus on the future rather than holding back to the past.

In Mahatma Gandhi's words – *"The Future depends on what we do in the present!"* And so what we learn and impart today will show results, tomorrow. At the Chamber, in line with our tag line *"Gateway to Professional Growth"*, we work to create a better tomorrow and we work today to shape the coming tomorrow. It is said by Swami Vivekananda that *"A Nation is advanced in proportion to the education and intelligence spread among the masses"*. So let's work together to learn, teach and grow; to use past as nothing but a learning experience, to see present as a gift to stitch a bright tomorrow and to see future as a medium of seeing the reality turn out of a dream we see today!

This month is known for Aardh Kumbh Mela in Prayagraj, India with arrival of more than 4 crore tourists and devotees for the shahi holy dip. In Prayagraj, hearing the word "Kumbh", creates the picturesque vision of Triveni sangam in one's mind, at the sacred confluence of rivers Ganga, Yamuna and Saraswati, and becomes the greatest of ephemeral city in the world. This was one of the reasons to organise our 42nd RRC at Lucknow in this holy period of Kumbh.

We will also see the lower house of Parliament observe its last sitting with the existing Government before general elections to form the 17th Lok Sabha in a course of few months. This interim budget was bigger than expected vote of account and unique with several roadmaps, directions and vision statements for bright future, and above all, impressively delivered by a Chartered Accountant for the first time in the history of Independent India.

February month also welcomes the Chinese New Year called "Year of the Pig", also famously known as the Lunar New Year which occurs every year on the new moon of the first lunar month. The Korean, Vietnamese and Tibetan new years also fall in and around the same time. May this lunar New Year usher global peace and fraternity for mankind and mother earth.

CTC Events

Our ***Lecture Meeting on TDS and CPC processing Programme*** was inaugurated by Ms. Anuradha Bhatia, Pr. CCIT (TDS), Mumbai and addressed by Mr. V. K. Gupta and Mr. Pratap Singh, CIT (TDS), Mumbai, Mr. Sunil Sharma, CIT (CPC), Ghaziabad, Mr. Ashok Jha and Mr. Kumar Sanjay both CIT (Appeals)-TDS, Mr. K. R. Narayana, Jt. Director – CPC, Bengaluru, Mr. Saurabh Arora ITO (TDS), Ghaziabad with attendance of more than 275 members and taxpayers. Several members got resolutions to their queries raised during the panel session and discussion.

Statutory interpretation is the process by which courts interpret and apply legislation. We are pleased to announce the ***3rd Study Course on Interpretation of Taxing Statutes*** on the 16th, 22nd and 23rd of February. The Speakers are very senior lawyers who shall share their experience on interpretation.

The 8th Dastur Essay Competition has received record enrolments and has crossed 400 numbers. At the request of few Students, we have extended enrolments up to the 15th February, 2019. I would request the students and budding professionals, who are passionate about expressing themselves through their words, to take this opportunity to get their creative ideas flowing and allow the author within to blossom.

We had record turnout and registration for ***2nd Chamber's Debate Competition*** with participation of 24 colleges and firms with winning team from Nari Gurshahani Law College.

30 boys and 6 girls team participated in the 1st Edition of ***CTC Box Cricket Tournament*** amongst CA and Law Firms.

Members' talent event called ***"Surila Yaarana"*** was great success attended by more than 225 members of Chamber and got enthralled in melody of our own singers and Bamboo beats.

We are planning ***Industrial visit for Students*** on 22nd February, 2019 to Volkswagen Car factory and Parag Milk Dairy at Pune.

The Chamber has given huge number of registration (2nd highest) for ***Joint Workshop on GST Law*** organised by 6 organisations.

This month will see the Delhi Chapter Committee hosting a full-day ***Seminar on Angel tax, Section 56 and its Interplay with Section 68, Benami & PMLA and Valuation issues under Income tax, its related legal issues*** on 9th February, 2019.

The Chamber is restarting its popular ***Direct Tax Refresher Course*** in March, 2019 after a huge gap and promises to be very interesting and innovative.

Our GST RRC at Hyderabad was a resounding success and reached newer heights in terms of technical contents, hospitality and conference arrangements. Our 42nd RRC at Lucknow is already full and we have closed registration. The RRC will be inaugurated by Hon'ble UP Governor, Shri Ram Naik ji who has kindly consented.

We are in final stages to announce ***MOOT Court Competition*** jointly with Government Law College in March, 2019.

The Chamber has filed its suggestions to the ***Finance Bill, 2019*** on various issues and corrections required. I thank Abhitan Mehta and Anish Thacker for helping and preparing such representation in very short time. We also held ***Investor Awareness Programme*** on 2nd February, 2019 for public, on eve of Interim Budget jointly with 4 organisations.

Special Story for February, 2019 on "Concept relevant to Taxation, Law & Practice" will be useful for members to understand fundamental rules of interpretation and principles of taxing statutes. I thank Mr. K. Gopal and Mr. Ajay Singh for preparing the design and structure of this special story, which is unique and conceptual, and also senior authors who have spared their time and made timely contribution.

I understand few members have complaints about non receipt of Journal, and we are taking steps to ensure timely delivery. I request members to kindly send their comments and feedback on matters related to The Chamber on office@ctconline.org and hineshdoshi67@gmail.com.

Thanking you.

Hinesh R. Doshi
President

Bommaraju Ramakotaiah, *Advocate*

Concept of Real Income

Oft repeated statement of Lord Macnaghten *"Income Tax, if I may be pardoned for saying so, is a tax on 'income'. It is not meant to be a tax on anything else"* explains the concept of real income. It is in this context the argument that an income has to be real income to be taxable has been found to be an attractive one. Central Government has the power to levy tax on income, other than agricultural income, as specified by Entry 82 of List 1 of Constitution of India. Income Tax is a charge on the income of a person, earned during the previous year, at the rate(s) specified in the relevant Finance Act. Income of an assessee has to be computed in the manner laid down under the Income-tax Act (Act). The Act has made elaborate provisions for classification of incomes under various heads and deductions permissible under each head. Under the Act, income is chargeable to tax on the basis of either receipt or deemed receipt in India in the previous year relevant to the year of which assessment is made or the income that accrues or arises or deemed to accrue or arise in India during such year. But,what is income has not been defined and the Income-tax Act, 1961 provides for an inclusive definition which has wide connotations. It is by now well-settled that income which is susceptible to tax is the real income as is commercially understood. In determining the real income, the question is not the physical receipt of income but of the concept of receipt in law.

Real income theory

When there is no provision of exemption or deduction in the law, the concept of real income has been considered in ascertaining whether an amount is taxable or not. The Privy Council in *Commissioner of Income Tax vs. Chetnavis (SM) AIR 1932 PC 178* had allowed a bad debt as an allowable item on the basis of commercial principles, when there is no provision in law to allow such claim. The Hon'ble Supreme Court in the case of *Badridas Daga vs. Commissioner of Income Tax, 34 ITR 10 (SC)* had allowed 'loss on embezzlement', though not an expenditure, as a deduction on the principle of real income theory. This theory is propounded more particularly when there is no assistance in the form of law, so that tax was levied on real income and not on hypothetical income, either on the basis of the entries in the books of account or otherwise. There are many grey areas as to whether a particular receipt is income or a particular payment is a revenue expenditure on which a decisive answer was not forthcoming. The concept of real income is often invoked to decide the issue one way or the other. Courts have used this concept for ensuring that what is taxed is nearly real as possible within the constraints of statutory limitations. The concept of real income, i.e., what is to be subject to tax is only the real income and not income in the hypothetical sense, has been established for a long time. In *Poona Electric Supply Co. Ltd. vs. CIT [1965] 57 ITR 521 (SC)* it was held that tax is exigible only on income earned in reality. In examining a transaction, the court would have more regard to the reality of the situation and lay greater emphasis on the business aspects of the matter when that can be done without disregarding the statutory language as held by Hon'ble Bombay High Court in the case of *H. M. Kashiparekh & Co. Ltd. vs. CIT [1960] 39 ITR 706 (Bom.).* At the same time where there are special provisions for computation for particular types of income, the concept of real income has no real application. *[Life Insurance Corporation of India vs. Commissioner of Income Tax, 119 ITR 900 (Bombay)].* The computation of such income is to be made in accordance with the method of income regularly employed by the assessee as per the provisions of section 145. Even if entries are made in the books of account, what is relevant is the entries that are made on accrual basis i.e. accrual of right to receive payment or the accrual of liability to disburse or pay, as held by the Hon'ble Supreme Court in the case of *Godhra Electricity Co. Ltd. vs. CIT 225 ITR 746 (SC).* When income is in fact received but subsequently given up, it remains the income of the recipient and tax is payable in the year of accrual. When income has not accrued at all, i.e., neither accrual nor receipt of income, even if there an entry to that effect in the books of account, the same cannot be considered as income. Notion of real income cannot be brought into play where income has accrued, according to the accounts of assessee. Some difficulty in recovery would not make its accrual, a non-accrual as held by the Madras High Court in the case of *CIT vs. Annapuram Veerappan [193 ITR 426 (Madras)].* The principle was followed in the case of *CIT vs. Hindustan Motors Limited [202 ITR 839 (Calcutta)].*

However, the theory does not apply to certain artificial incomes which are deemed to be income under the provisions of the Act; it also does not apply to income resulting from the disallowance of certain expenditure which may be genuine, and has been incurred for the purposes of business, but is restricted under the provisions of the Act. The concept of real income has also no application where there are special provisions for the computation of a particular type of income.

The Hon'ble Supreme Court in the case of *'State Bank of Travancore vs. Commissioner of Income Tax' 158 ITR 102 (SC)* had an occasion to invoke the concept of real income and laid down the principles on this subject which are relevant even today. It was held [in majority view] that *the question of how far the concept of real income entered into the question of taxability in the facts and circumstances of this case and how far and to what extent the concept of real income should intermingle with the accrual of income will have to be judged in the light of the provisions of the Act, the principles of accountancy recognised and followed the feasibility. An acceptable formula of correlating the notion of real income in conjunction with the method of accounting for the purpose of computation of income for the purpose of taxation is difficult to evolve. Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of real income theory. After accrual, non-charging of tax on the same because of certain conduct based on the ipse dixit of a particular assessee cannot be accepted. In determining the question whether it* *is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account. It would be difficult and improper to extend the concept of real income to all cases depending upon the ipse dixit of the assessee which would then become a value judgment only. What has really accrued to the assessee has to be found out, and what has accrued must be considered from the point of view of real income, taking the probability or improbability of realisation in a realistic manner and dovetailing these factors together, but once the accrual takes place, on the conduct of the parties subsequent to the year of closing, an income which has accrued cannot be made 'no income'. In this connection the following proposition emerge:*

(1) It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation.

(2) The concept of real income would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation no income had resulted because the income did not really accrue.

(3) Where a debt has become bad, deduction in compliance with the provisions of the Act should be claimed and allowed.

(4) Where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act.

(5) If there is any diversion of income at source under any statute or by overriding title, then there is no income to the assessee.

(6) The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not.

(7) Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry, but taking the interest merely in suspense account, cannot be such evidence to show that no real income has accrued to the assessee or has been treated as such by the assessee.

(8) The concept of real income is certainly applicable in judging whether there has been income or not, but in every case it must be applied with care and within well-recognised limits, and must not be called in aid to defeat the fundamental principles of law of income-tax as developed.

Above principles are laid down following the concepts of accrual of income, method of accounting followed, conduct of parties, diversion/application of income and statutory provisions. Keeping the principles laid down as above, one can analyse the concept in various situations.

Real income and accrual of income

Income becomes taxable on the footing of accrual only when the right to receive the income becomes vested in the assessee. The Supreme Court in *E. D. Sassoon & Co. Ltd. vs. CIT [1954] 26 ITR 27,* had held that if the assessee acquires a right to receive the income, the income is said to have accrued to him, though, it may be received later on. The basic concept is that he must have acquired a right to receive the income. In other words, there must be a debt owed to him by somebody. Unless and until a debt is created in favour of the assessee by somebody, it cannot be said that the assessee has acquired a right to receive the income or the income has accrued to him. Broad principles of accrual of income have been laid down from time-to-time by various Courts including the Supreme Court, e.g., in *CIT vs. Ahmedbhai Umarbhay & Co. 18 ITR 472*

(SC), Indermani Jatia vs. CIT 35 ITR 298 (SC), CIT vs. A. Gajapathy Naidu 53 ITR 114(SC) and Morvi Industries Ltd. vs. CIT 82 ITR 835 (SC); however, where income cannot be said to have resulted at all, there is neither accrual nor receipt of income, even though an entry might have been made in the books of account as held in *CIT vs. Shoorji Vallabhdas & Co. 46 ITR 144 (SC).* In the decision of *CIT vs. Sitaldas Tirathdas 41 ITR 367,* Hon'ble Supreme Court has ruled that what is to be subject for taxation is only real income over which the assessee possesses a right and not any other thing. In *Somaiya Organo Chemicals Ltd. vs. CIT 216 ITR 291,* the issue considered by Bombay High Court was – whether the cess collected and kept in a separate bank-account as per the statutory order and to be utilized for a particular purpose, was 'income' in the hands of assessee? It was held that the 'statutory levy' could not be equated as the 'real income' of the assessee. In *Rajkot District Gopalak Co-op. Milk Producers' Union Ltd. vs. CIT 204 ITR 590,* the question which fell for consideration was-whether income of the project assigned to a Co-operative Society on lease and license basis and profits of which were to be paid to the State Government, could be treated as 'income' of the assessee? It was held that the entire income belonged to the Government and it could not be treated as the income of the assessee and was thus not taxable. Similarly, in *CIT vs. Pepsu Road Transport Corpn.253 ITR 303 (Punj. & Har.)*, the Court considered the question as to whether the amount forfeited by the employer out of the provident fund where it was categorically mentioned that the said amount belonged to the Trust, was income of the assessee. Invoking the concept of 'real income', the High Court held the same not to be the income of the assessee. A somewhat similar view was taken in *Gujarat Municipal Finance Board vs. Dy. CIT (Assessment) 221 ITR 317 (Guj.).* It was decided by the Supreme Court in the case of *K. P. Varghese vs. ITO 131 ITR 597(SC)* that what in fact never accrued or was never received cannot be computed as capital gains under section 48. Though the aforesaid case was related to capital gains, it equally applies to the case of principle of real income. In deciding the case on real income principle one major problem arises as to the 'burden of proof'. It was decided in *K. P. Varghese's* case (supra) that the burden lies on the revenue to show that there is an understatement of consideration. Thus, the principles laid down in the State Bank of Travancore particularly principles 1, 2, 6 & 7 are keeping in tune with the concept of accrual of income.

Real income and method of income

It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred. One important aspect in understanding the concept of real income is the method of accounting being followed by the assessee. Sometimes due to accounting norms or due to business expediency, assessee may have to account for certain transactions as income even though they may not result in real income to the assessee. This issue has troubled not only the assessee but also the judiciary over a period of time. There are various cases on this issue but the underlying principle to examine is whether a particular transaction has really resulted in an income during the year on the concept of real income theory.

There is no dispute to the fact that the books of account maintained should represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of prescribed accounting policies. Therefore, even under the mercantile method of accounting, the assessee is justified in following the policy of not recognizing the revenues till the point of time when the uncertainty to realize the revenues vanished. In State Bank of Travancore's case (supra) Supreme Court had held that interest had accrued mainly on the ground that the bank had not written off the related debt as a bad debt, as required under section 36(1)(vii). At the same time, in the cases of *CIT vs. U.P. Financial Corpn. 194 ITR 282 (All.), CIT vs. Orissa State Financial Corpn. 201 ITR 595 (Ori.); CIT vs. U.P. Financial Corpn. 217 ITR 191 (All),* it was held that interest did not accrue during the entire period in which suits were filed for the recovery of the loans, and awarding of interest for the period was within the discretion of the Court. When the Government refused to pay the interest which was credited in the books by assessee and assessee reversed the interest credited in earlier years and stopped crediting the interest account, it was held that interest did not accrue – *CIT vs. Rajasthan Financial Corpn. [1994] 205 ITR 478 (Raj.).* Justice Tulzapurkar giving a dissent note in the case of State Bank of Travancore (supra) has opined that *the method of accounting regularly employed by an assessee is relevant only for the purpose of computation of income, profits and gains under section 28 of the Act and it cannot enlarge or restrict the content of the taxable income under the Act and under section 145. The assessee's regular method of accounting determines the mode of computing taxable income but it does not determine or even affect the range of taxable income or ambit of taxation. In other words, simply because the assessee has been regularly employing the mercantile system of accounting, it would not mean that any hypothetical income which may have theoretically accrued but has not truly resulted to him in the concerned accounting year can be brought to charge and, therefore, the question whether the said sums representing interest on sticky loans had really accrued to the assessee or not would be a matter of substance and could not be determined by merely having regard to the method of accounting (here, the mercantile system) adopted by the assessee. …also, the theory of real income must apply to all cases irrespective of who the assessee is.*

Honourable Supreme Court in a later judgment of *UCO Bank vs. CIT 237 ITR 889 (SC)* has not followed the decision in State Bank of Travancore (supra), but it was not on the inference relating to the concept of real income. The observations of J. Tulzapurkar are valid on the issue of real income theory. However, Accounting standards (AS as well as ICDS) now being prescribed u/s. 145, sometimes deviate from the concept of real income. For example, Ind-AS 109 stipulates that upon waiver of loan the difference between the carrying amount of the loan and the consideration actually paid towards such waiver would be routed through Profit and Loss account. Therefore, if a financial liability being a loan is extinguished without paying any consideration, the entire extinguished liability would be treated as part of income of the debtor, thus attracting MAT provisions, despite the fact that waiver of loan is regarded as Capital receipt as per the decision of Supreme Court in the case of *CIT vs. Mahindra and Mahindra Limited, 404 ITR 1 (SC).* At the outset, it is to be remembered that there is a basic difference in the tests for real income laid down by the Supreme Court, which are essentially for the purpose of determining income chargeable to tax under the Act, and the Accounting Standards, which are to be drawn up "in conformity with the provisions of the applicable laws" to present a "true and fair view" (commercially) for all business enterprises following the mercantile system of accounting.

Sometimes, even the book entries made by assessee may not clear the doubt, in such a situation, court can consider the treatment given to a particular item of receipt by the other party to the contract. Thus, the conduct of the parties, mainly of the recipient is also implicitly considered while deciding the issue.

Real income and Diversion of Income

Principle 5 pertains to an issue of application of income or diversion of income, which is dealt with elaborately in another article. Suffice to say that an obligation to apply the income in a particular way before it has accrued, arising or has received by the Assessee results in diversion of income. On the other hand, an obligation to apply income which has accrued, arisen or have been received is only apportionment of income. The diversion can be by statute or by an overriding charge created in a law by a court's decision, agreement, voluntary settlement etc.

Real income and Statutory Provisions

Principles 3, 4 and 8 basically support the provisions of the Act, which differ from concept of real income in treating certain receipts as income. There are differences between the taxable income and the real income. An assessee pays tax on his taxable income, which may or may not be his real income or some portion of the taxable income may contain income which is not real income. There are number of provisions under which income is deemed to accrue or arise by way of statutory fiction, e.g., sections 9, 12, 45, 68, 69, 69A, 69B, 69C, 69D, 93, 94 and 172(2) of the Act, and these incomes will have to be assessed, whether shown in the accounts as such or not. However, an exception is provided to the effect that upon discharging initial burden placed upon assessee to prove that assessee has not earned such income, it would be upon Revenue to prove to the contrary under most of the provisions.

There are specific provisions in the Act which suggest payment of tax on the basis of certain percentage of the gross receipt irrespective of the expenditure incurred for earning the said income. This is commonly known as presumptive taxation. Some of the sections are 44AD, 44AE, 44AF 44B, 44BB, 44BBA, 44BBB, etc. Use of Sections 68, 69, 69A 69B, 69C and 69D forces the assessee to pay tax on his income which may not be his real income. In the case of salaried employee, salary is to be assessed under the head 'salary income'. The allowances and benefits received by way of monetary benefit are incomes in the real sense, whereas the perquisites are not real income but notional income. An attempt was made to tax the rent-free accommodation given to a salaried employee at market rates few years back but was withdrawn as that value may be more than the salary being received and the tax component may be more than the actual receipt of salary thereon, particularly in Metro cities. Wise sense prevailed in withdrawing that and now perquisites are being taxed at a nominal value, even though there is no monetary advantage on that. Under the head 'income from house property', the provisions of Section 23(1)(a) specifies that annual value of any property shall be deemed to be the same for which the property might reasonably be expected to be let from year to year. This deeming provision is against the concept of real income and sometimes, it may happen that the income so estimated or arrived at can be more than the income of the person in monetary terms. In the case of *Ansal Housing Finance & Leasing Limited, 354 ITR 180 (Del.),* the Hon'ble High Court has upheld the revenue contention that unsold flats, which are stock-in-trade in the business can also be considered to bring the Annual Letting Value to tax. The Finance Act, 2017 has given some relief to an extent of one year from the rigours of this judgement, by insertion of Section 23(5) w.e.f. 1-4-2018. It is not understandable how income from house property can be assessed on stock-in-trade as it goes against the provisions of Section 22 as the said stock-in-trade is business property and profits thereon are chargeable to tax, therefore, gets excluded u/s. 22.

Coming to the head 'Profits and Gains of Business or Profession', there are many provisions which either consider income by deeming notional incomes and also various provisions to disallow expenditures which are otherwise spent, or for various statutory violations considered as income; for example: Sections 36(1)(va), 43B, 40(ai), 40(a)(ia), 40(b).

Even under the head 'Capital Gains', provisions of Section 50C/50CA goes against the concept of real income. It casts unnecessary burden upon the assessee to prove that no such notional income was earned at all. Section 50C(2), however, permits an assessee to challenge the action of Assessing Officer in which event there is a provision to obtain technical expert's report. The deeming provisions of dividend and taxing share premiums in certain situations, provisions regarding cash credits, unexplained investment and unexplained expenditure are some of the provisions where notional incomes/ deemed incomes/capital receipts are considered as incomes.

The provisions of 'transfer pricing', in a way, also contains deeming provisions with reference to Arm's Length Price, which an assessee may not have earned but are deemed to be income, as per the statutory provisions. Thus, the principles 3, 4 and 8 laid down by the Supreme Court takes care of special provisions of the Act wherein concept of real income cannot be canvassed.

It is rightly opined in the case of State Bank of Travancore (supra) that the concept of 'real income' cannot be so 'real' so as to defeat the object and the provisions of statutory enactment. The object of incorporating certain deeming provisions are meant to reduce the burden on the assessing authority from collecting certain data which is within the personal knowledge of the assessee and hence initial burden is placed upon the assessee to prove that no such income was earned. No doubt, equity and taxation are strangers, but it should not be extended to rope in some income which an Assessee could have never earned or to punish an assessee by way of incorporating deterrent provisions by assuming that under certain circumstances an Assessee is liable to tax on deemed income.

After all, the concept of taxation, traced back to the Chanukya's philosophy, was compared to the process of collecting honey from the flowers in such a manner that neither the fragrance nor the texture of the flower is affected. Applying the same logic, tax has to be collected from a businessman or a taxpayer in such a way that it should not put undue pressure on the person to prove that no such income was earned at all; the present trend of the Revenue by bringing out certain deeming provisions, giving a go by to 'real income principle' may affect the very business itself. After all, if the economy grows, there would be overall development in the country which in turn would result in larger tax collection which can be utilised for public good.

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By declaring we are weak, we become weak, we do not become better.

— *Swami Vivekananda*

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Harsh M. Kapadia, *Advocate*

Diversion of Income by Overriding Title

Introduction

"In this world, nothing can be said to be certain, except death and taxes". The year was 1789, when Benjamin Franklin is believed to have first said these famous words. 250 years have passed since then and the accuracy of this expression has proved to be almost precise. The reason why it is not totally accurate is that the application of this expression is not universal. When it comes to income taxes in India, one cannot always be sure about levy of taxes on income.

In our country, income tax laws have been around for over one and half century. Following the Mutiny of 1857, the British Government faced an acute financial crisis. Thus, in order to fill up the treasury, the first Income-tax Act was introduced in February, 1860 by James Wilson, who became British – India's first Finance Minister (source : https://www.thehindubusinessline.com/2000/02/14/stories/211464tn.htm). Thenceforth, there were many developments in the field of taxation. Three independent Income-tax Acts were passed by the British Government (Indian Income-tax Act of 1886, Indian Income-tax Act of 1918 and Income-tax Act of 1922) before the existing Income-tax Act, 1961 ('Act') was enacted by Government of Independent-India.

In spite of formal income tax laws having existence for over 150 years in India, one area where "certainty" of tax (as expressed by Benjamin Franklin) is not definite is the application of doctrine of 'diversion of income by overriding title' and 'application of income'. Though very simple to understand, this concept has had its own difficulty in interpretation to a given set of facts. Our courts have pronounced diverse judgments based on hair splitting interpretations of the said principle. To give a perceptive of this diversity and also the 'uncertainty', the very first issue of the 'Income Tax Reports' (ITR) came out in the year 1933 and at page 135 of this issue, the publishers have reported a judgment of a 5–Judge Bench of the Privy Council in *Raja Bejoy Singh Dudhuria vs. CIT*. This decision continues to be referred even today by courts while resolving disputes between the taxpayers and revenue authorities on the subject issue.

Through this article, an attempt has been made to consolidate the divergent opinions rendered by various judicial authorities and also throw some light on the significant nuances of the doctrine, with the hope to bring some clarity in this extremely litigious issue.

Significance of this doctrine

As one ploughs deeper into the subject, he finds that the distinction between the 'application of income' and its 'diversion by overriding title' is very thin. Nevertheless, it is important to distinguish the two because a mere application of

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income after it has been earned by an assessee, will not excuse him from taxes, whereas if a part of the income is diverted by overriding title, it will not be subjected to any tax, on the ground that it is not the income of the assessee.

What is 'Diversion of Income by Overriding Title'?

More often than not, income earned by an assessee is consumed for the purpose of meeting some recurring and non-recurring expenditure arising out of an obligation imposed on the assessee by some contract, or by a statue, or in the case of a company, by the memorandum and articles of association governing it. In such cases, the question arises whether such income so expended is to be treated as income assessable to tax in the hands of the assessee. This is where the principle of 'diversion of income by overriding title' comes into play.

In past, brilliant minds have spent countless hours to devise and establish a universal test to answer the question as to whether an income actually belongs to another person. However, the only answer that has always been achieved from such exercises is that there can be no bright line rule to determine this contentious question and that each case has to be evaluated from its own surrounding facts and circumstances.

In principle, doctrine of 'diversion of income by overriding title' signifies that an income which merely is received by or accrued to an assessee, actually belongs to somebody else. It indicates an obligation to divert the income in a particular manner before it accrues to or is received by the assessee. Though the assessee was legally entitled to receive the income, it was not his income at the very outset. Say an income is received by the assessee and held in trust on behalf of its real owner, who acquires a title over the income before it reaches the hands of the assessee. This occurs when, by reason of a superior title or overriding obligation, voluntary or otherwise, income is diverted at the source itself and it never reaches the person whose hands it is sought to be assessed. The income earned by the assessee is really not his income, but belongs to somebody else and the assessee has no title to it. On the contrary, if the source is not assigned to, or transferred but passes through the assessee to an ultimate purpose, the case is of application of income in a particular manner. Even though he may enter into a legal obligation to apply it in a certain way, still it remains the income of the assessee. This distinction has been maintained by Hon'ble Supreme Court on numerous occasions. See for example *Raja Bejoy Singh Dudhuria vs. CIT [1933] 1 ITR 135 (PC); P. C. Mullick vs. CIT [1938] 6 ITR 206 (PC); CIT vs. Sitaldas Tirathdas [1961] 41 ITR 367 (SC)* and *Vibhuti Glass Works vs. CIT [1989] 177 ITR 439 (SC).*

In the case of *CIT vs. Sunil J. Kinariwala [2003] 259 ITR 10*, the Hon'ble Supreme Court has, after referring to various precedents on the subject, explained the aforesaid expression in the following manner:

"When a third person becomes entitled to receive the amount under an obligation of an assessee even before he could lay a claim to receive it as his income, there would be diversion of income by overriding title; but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not of diversion of income by overriding title."

Further, recently the Hon'ble Supreme Court in the case of *DCIT vs. T. Jayachandran [2018] 406 ITR 1* has clarified that the income which actually accrues to assessee is taxable, which is to be decided, not by reference to physical receipt of income, but by the receipt of income in reality.

It is well-settled that in order to tax an income one has to see whether it is the real income or whether the income has materialised. What is necessary to be considered is the true nature of the transaction and whether in fact the transaction has resulted in profit or loss to the assessee. The income should not be hypothetical income but real income. The foundation of the doctrine of 'diversion of income by overriding title', one can say, is the adaptation of concept of real income theory. Both the principles signify that an assessee cannot be subject to tax if the income is not "really" his.

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Chapter V of the Act dealing with "Income of Other Persons, Included in Assessee's Total Income" imprecisely integrates the principle of 'diversion of income by overriding title' and 'application of income'. Section 60 of the Act provides for situations wherein income which is generated from an asset, is transferred without transferring the asset itself. In such situations, the said income is chargeable to tax as the income of the transferor and shall be included in his total income. Therefore, the said section has a limited application to it, that is it applies only to a case where income accrues to the transferee but the income earning asset or source of income remains with the transferor.

Similarly, section 61 of the Act states that a revocable transfer of an asset by a person will not lead to transfer of taxability of any income which is generated from such an asset and thus, the same shall continue to be taxed in the hands of the person who transfers the asset.

When income is said to be diverted by overriding title?

The principle is simple enough but now and again, the question arises as to what is the criteria to determine, when does the income attributable to an assessee get diverted by overriding title? It may be difficult, in a particular case, to distinguish between what is an 'application' of income and what amounts to 'diversion'.

The landmark case of the Supreme Court in *CIT vs. Sitaldas Tirathdas (supra)* is probably the best answer to this vexed question. A 3 Judge Bench of the Apex Court has wonderfully explained in what circumstances there is a diversion of income by overriding title and where the income can be said to have been applied after it is received by a taxpayer.

The assessee in that case, claimed a deduction from his total income, the amount paid under a consent decree as maintenance to his wife and children. The assessing officer however disallowed said deduction, which was confirmed by the Commissioner and also the Tribunal. On reference, the Hon'ble Bombay High Court held that the income to the extent of the decree must be taken to have been diverted to the wife and children, and never became income in the hands of the assessee and hence, was an allowable deduction. The revenue challenged this before the Hon'ble Supreme Court. Justice M. Hidayatullah (as His Lordship then was), reversed the decision of the High Court and while doing so, held as under:

"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Whereby the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable. In our opinion, the present case is one in which the wife and children of the assessee who continued to be members of the family received a portion of the income of the assessee, after the assessee had received the income as his own. The case is one of application of a portion of the income to discharge an obligation and not a case in which by an overriding charge the assessee became only a collector of another's income. The matter in the present case would have been different, if such an overriding charge had existed either upon the property or upon its income, which is not the case. In our opinion, the case falls outside the rule in Bejoy Singh Dudhuria's case (supra) and rather falls within the rule stated by the Judicial Committee in P.C. Mullick's case (supra)."

Therefore, what the above stresses is the nature of the obligation by reason of which the income becomes payable to a person other than the one entitled to it. The expressions 'reaches the assessee' and 'has been received' have not been used in the sense of the income being received by one person or another. Where the obligation flows out of an antecedent and independent title in the former (such as, for example, the rights of dependants to maintenance or of coparceners on partition, or rights under a statutory provision or an obligation imposed by a third party and the like), it effectively slices away a part of the corpus of the right of the latter to receive the entire income and so it would be a case of diversion. On the other hand, where the obligation is self-imposed or gratuitous, it can be only a case of an application of income. See *Moti Lal Chhadami Lal Jain vs. CIT [1991] 190 ITR 1 (SC)* wherein the above has been laid down.

Further, the appearing or non-appearing of a particular income in the books of account of an assessee is not a relevant criteria to determine the question of 'diversion of income'. As held by the Hon'ble Supreme Court, the expressions 'reaches the assessee' and 'has been received' have been used not in the sense of the income being received by one person or whether it has entered into the books of account. Therefore, just because certain income is not recorded in the books of account of an assessee but in some other person's books, one can still hold that such income was of the first person.

It will not be out of place to clarify here that what is relevant is a charge on the 'source' of income. The fact that a charge has been created on some assets by itself cannot take a case out of the category of 'application of income'. Though a charge of asset may aid in determining the vital question of 'diversion' vs. 'application'. However, it is certainly not a conclusive yardstick. Say a charge created by an assessee on some assets voluntarily and by his own choice, for the purpose of maintaining his wife and children, will not make the appropriation of income a case of 'diversion'. Conversely, a case can fall within the ambit of 'diversion' even though there is no specific charge on assets is created. Diversion of income signifies an absolute obligation on the assessee to part with a piece of his income.

In many judgments delivered subsequent to the decision of Justice Hidayatulla (*supra*), various courts have, from time-to -time, analysed the law in this regard and have suggested various tests to find out whether, in a given set of facts, was the case an event of 'diversion' or 'application' of income. However, all these diverse tests revolve around and/or the supplement the "true test" formulated in *Sitaldas Tirathdas (supra)*.

One such instance is of the Hon'ble Allahabad High Court in the case of *U. P. Bhumi Sudhar Nigam vs. CIT [2006] 280 ITR 197.* Here the High Court devised a set of four tests to determine the taxability in the hands of an assessee under this principle. After analysing various other judgments including *Sitadas Tirathdas (supra)*, it suggested the following:

> *"24. From the aforesaid cases the following principle emerges:*
>
> *(i) If a third person becomes entitled to receive an amount under an obligation of an assessee even before he could claim to receive it as his income, there would be a diversion of income by overriding title but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not of diversion of income by overriding title.*
>
> *(ii) If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about the hypothetical income which does not materialise.*
>
> *(iii) The existence or absence of entries in his books of account cannot be decisive or conclusive in the matter.*
>
> *(iv) The concept of 'real income' must be applied in appropriate cases but with circumspection and must not be called in aid to defeat the fundamental principle of law of income-tax as developed."*

Thus, to make a clear distinction between the two principles, our judiciary has emphasised on the identification of nature of the obligation that is to be discharged by an assessee. Every income has a source either as a property or a business or a contract. There is a difference between an obligation to spend money in a particular manner attached to the income and a similar obligation attaching to the source of income. If the obligation is on the receipt of the income and not on the source of it, the legal effect is different. In the latter, income is diverted at the source and, hence, cannot be deemed to have accrued or arisen therefrom. Whereas, in the former, the income has accrued and, therefore, it has to be applied in a particular manner.

Instances of Overriding Title

Having roughly understood the doctrine of 'diversion of income by overriding title', let us travel through certain specific and contentious illustrations on the subject, where courts have taken diverse views (considering the size and extent of this topic and the limitation of the words allotted for this article, only "certain" illustrations can be covered here). The variety of opinions has arisen on account of fine differences in the facts and circumstances of each case, which in view of the judiciary were material for the conclusion so held by them.

Under legal obligation of a 'Partnership Deed'

It is not uncommon for a partnership firm to be under a legal obligation to act in a particular manner (say disburse some payments in favour of a third person). This legal obligation flows through the partnership deed of the partnership firm. In such a scenario, issue arises as to whether the obligation, which the firm is legally bound to carry out, can be said to be 'diversion' or 'application'?

For such situations, let us first look at the decision of the Hon'ble Bombay High Court in the case of *CIT vs. Crawford Bayley & Co. [1977] 106 ITR 884.* In this case, under the provisions of its partnership deed, the widows of partners N and L were made some payments monthly, which were claimed as deductions by the assessee-firm. The revenue authorities rejected the claim holding that the widows were not parties to the partnership agreement, that they had no rights against the firm, that the payments to them were purely voluntary, that it was open to the partners to modify or stop making payments without the consent of the widows and that, as the payments had to be made irrespective of profits or losses resulting to the firm, the payments had no bearing on the income of the firm and were not a charge on the firm. The Appellate Tribunal accepted the claim of the assessee and took the view that there was an obligation in the nature of a trust on the surviving partners to make the payments.

The appeal of the Income-tax department was dismissed by the Hon'ble High Court. After analysing the partnership deeds minutely, the High Court concluded that case of the assessee was of 'diversion by overriding title' and accordingly, the amounts paid to the widows could not be taxed in the hands of the firm. The High Court, applying the "true test" formulated in *Sitaldas Tirathdas (supra)*, held that under the partnership deeds, the firm was to continue for an indefinite period and was not to be dissolved by death of any partner and accordingly, there was a clear and explicit provision that upon the death of any active partner, the surviving partners would succeed to the share of the outgoing partner in the partnership business and the property and goodwill thereof. It noted that even though a partner ceased to be a partner by reason of his death, his legal representative was not to be entitled to any share in the goodwill of the firm or compensation in lieu thereof. The payment to the widow of a deceased partner under the partnership deed was absolute and not dependent upon the assessee-firm incurring any profits or losses. Further, the High Court also held that even though a person may not be a party to a contract he can enforce his right under contract by adopting appropriate legal proceedings and thus, in that case, it was clear that the facts of that case were an obligation in the nature of trust.

Similarly, in the case of *CIT vs. Mulla & Mulla & Craigie Blunt & Caroe [1991] 190 ITR 198,* the

Hon'ble Bombay High Court once again referred to the clauses of the partnership deed and held the assessee firm was under a legal obligation in terms of the deed of partnership to pay outstanding fees for the work done up to and during the period when the deceased partners were partners. Hence, it was concluded that the case was an instance of the source of income being subject to an obligation and accordingly, the amounts paid to legal heirs of deceased partners never reached the assessee-firm as its income. Here too, the High Court relied upon the rule crafted in *Sitaldas Tirathdas (supra).* The Hon'ble Madras High Court reiterated the above principle in *CIT vs. Subramaniam Bros. [1999] 236 ITR 148.*

On the other hand, the Hon'ble Calcutta High Court in the case of *K. C. Bose & Co. vs. CIT [1985] 156 ITR 701* wherein it was held that amount paid by surviving partners to the widow of the deceased partner was not a case of 'diversion of income by overriding title'. In the facts in that case, on death of any partner, in terms of the partnership deed, his share of goodwill would automatically devolve on remaining two partners, in consideration whereof widow of deceased partner would be credited with a fixed sum payable in monthly instalments. On death of one of the partners, surviving partners while continuing partnership under fresh deed, voluntarily provided for payment of said amount to widow and a charge was created on all assets of assessee-firm. The High Court concluded that obligation to pay the widow was a personal obligation of the surviving partners and in order to discharge the said obligation, the surviving partners, while continuing the partnership under a fresh deed, voluntarily provided for payment of the amount and that the charge was created voluntarily for a limited purpose, namely, fulfilling a personal obligation of the partners.

Similarly, in the case of *CIT vs. V. G. Bhuta [1993] 203 ITR 249 (Bom.),* it was held that payments made subsequently to the widow of a deceased partner by the surviving partners who were empowered to continue the partnership, were not diverted by overriding title.

Thus, as can be seen from the above precedents, there has been no consistent view taken by courts and conclusion of each decision has been based largely on facts and circumstances of the respective case. An obligation, flowing from the partnership deed, to disburse certain amount in a particular manner, does not necessarily lead to the conclusion that the income is diverted by an overriding title. What is essential is that the obligation must be absolute and the income must be diverted at the source, before it reaches the hands of the assessee.

Under statutory obligation to set aside certain funds / create reserves

Many a times, companies are under a statutory obligation to set apart certain amounts from the profits earned by the company which are to be utilised for specific purposes only. Such obligations include set aside the profits into 'reserves' to be utilised in a particular manner. In such scenarios, question is often raised as to whether such appropriation of profits can be claimed to be 'diversion of income by overriding title' or it is a mere 'application of income'? Diverse opinions can also be found in such cases, few of which are discussed hereunder.

Section 205(2A) of the erstwhile Companies Act, 1956, was one such statutory obligation on companies, where it was mandatory to transfer certain percentage of profits into the general reserve of the company before declaring any dividend. The Hon'ble Madras High Court in the case of *Seshasayee Paper Boards Ltd. vs. CIT [1999] 237 ITR 488* held that reserves, even if created under a statutory compulsion may not be a case of diversion of income by overriding title since the amounts were transferred out of the own profits of the company. The High Court also held that even a statutory obligation on an assessee under section 15(1) of the Payment of Bonus Act, 1965, to allocate certain sums as set on in the succeeding year and to be utilised for the purpose of payment of bonus in particular manner was not a case of diversion of income by overriding title as there was no charge on the property and was a case of contingent liability. The High Court held that the money was not paid to the employees and the employees had no right over the money and the money could be used in the subsequent years for the business purposes of the assessee in certain scenarios.

The Hon'ble Supreme Court in the case of *Associated Power Co. Ltd. vs. CIT [1996] 218 ITR 195* has rested the controversy present then and held that an amount credited to contingency reserve fund under statutory provisions meeting possible exigencies cannot be said to be diverted by reason of an overriding obligation or title. It also distinguished an earlier decision in *Poona Electric Supply Co. Ltd. vs. CIT [1965] 57 ITR 521 (SC).* In *Poona Electric*, it was held that the amount credited to 'Consumers' Rebate Reserve' for the purposes of the Electricity (Supply) Act was a part of the excess amount paid to the electricity company and was reserved to be returned to the consumers and thus, it did not form a part of the electricity company's real profit. This decision was distinguished on the ground that the amount paid into the 'Consumers' Benefit Reserve' had to be returned to the consumers and it was as if the electricity company had not received the amount, whereas, in case of 'contingency reserve', the same was created so that money is always available for meeting these expenses and the supply of electricity is not interrupted. Therefore, the fact that the companies were obligated by a force of law was irrelevant in deciding the impugned question of diversion vs. application of income.

Similarly, the House of Lords in the case of *Mersey Docks and Harbour Board vs. Lucas (2 TC 25)* held that the harbour board, which is empowered by Act of Parliament to levy dock dues, etc., and which were to be applied in maintaining the concern, and in paying interest on moneys borrowed and any surplus income remaining after meeting these charges was directed to be applied in forming a sinking fund to extinguish the debt incurred in the construction of the docks, was a case wherein the surplus so remaining was the income of the board and was to be considered as application of income.

However, under the Molasses Control Amendment Order, a separate Molasses Storage Fund is required to be created, wherein a portion of the sale proceeds of molasses had to be credited to this fund and the same could not be used only for construction of storage tanks in accordance with the prescribed guidelines. The income set apart mandatorily under law was held to be diverted by overriding title and was not a case of application and thus, could not be taxed in the hands of the assessee. See *CIT vs. Ambur Co-op. Sugar Mills Ltd. [2004] 269 ITR 398 (SC) CIT vs. Salem Co-operative Sugar Mills Ltd. [1998] 229 ITR 285 (Mad.), CIT vs. New Horizon Sugar Mills Ltd. [1999] 237 ITR 102 (Mad.), SLP dismissed in [2004] 269 ITR 397 (SC)* and *CIT vs. Madurantakam Co-operative Sugar Mills Ltd. 2003] 263 ITR 388 (Mad.).*

Also, the Hon'ble Bombay High Court in *Somaiya Organo Chemicals Ltd. vs. CIT [1994] 117 CTR 1* held that the amount deducted from the sale proceeds of alcohol and spirit and transferred to storage fund for molasses and alcohol account under the Ethyl Alcohol (Price Control) Amendment Order, 1971 could not be considered as part of income of the assessee under section 28 as the assessee was under a statutory obligation to set aside the amount for the said fund at the inception and, therefore, there was clear diversion at source of that amount.

One vital factor which goes in deciding such cases is what is the nature of reserve that is created, whether the assessee company has any right, control or domain over the reserve and whether the amount set apart, for whatever purpose, is contingent in nature. The fact that the appropriation is mandatory in light of certain statutory or legal obligations may not be relevant. Also, cases where the appropriation of amounts is made from the revenues of an assessee, as compared to, from the profits is also an aspect which can influence the answer to the question as to whether such appropriation is diversion of income or merely an application. Say for example, an assessee if compelled to set aside a part of the revenue for a particular purpose, irrespective of the fact that the assessee has earned any profits or not from such revenues, may indicate that there is an absolute obligation on the assessee and therefore, may not be a case of mere 'application of income'.

Charge or mortgage created on assets generating income

As already stated earlier, self-created encumbrance by way of charge or mortgage on a property cannot automatically lead to the conclusion of diversion by overriding title. What is crucial is whether there is a charge on source of income itself and only in such cases where the source of earning income is charged by an overriding title, the same can be considered as diversion of income by overriding title. Therefore, in a case of capital gain earned where a mortgagee sold the property, which was mortgaged by the assessee and after withholding his share of interest, remitted the balance consideration to the assessee, it was held that the gains were made on an immovable property which belonged to the assessee and thus was a case of application of income and not diversion of overriding title on the ground. See *CIT vs. Attili N. Rao [2001] 252 ITR 880 (SC).*

It is quite customary for a person to receive, under a will, which is otherwise subject to a charge or mortgage, created by the person who bequeathed the said property (i.e. deceased person). A question therefore, may arise as to whether, on transfer of such immovable property, an amount which may be paid or parted with to release the charge or mortgage and acquire an absolute interest in the property can be consider diversion of income by overriding title (reference to a 'charge' or 'mortgage' here means that there is transfer of interest in the property mortgaged contrary to a in a charge where no interest is created in the property charged so as to reduce the full ownership to a limited ownership).

Firstly, it is pertinent to note that the person who creates a charge or mortgage is of great significance for the reason that in different scenarios, will result in creation of different rights and interests in the property and accordingly, such scenarios will have different tax consequences.

There is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to the mortgage created by the previous owner, the assessee acquires absolute interest in that property only after the interest created in the property in favour of the mortgage is transferred to the assessee, that is after the discharge of mortgage debt. However, where the assessee acquires a property which is unencumbered, then, the assessee gets absolute interest in that property on acquisition. Where a person has mortgaged a property during his lifetime, which is subsisting at the time of his death, then after his death his heir only inherits the mortgagor's interest in the property. By discharging the mortgage debt his heir who has inherited the property acquires the interest of the mortgagee in the property.

The position is, however, different where the mortgage is created by the owner after he has acquired the property or to put it in other words, the clearing off of the mortgage debt by the previous owner prior to transfer (bequeath) of the property will lead to a different outcome vis-à-vis the above position because in such a case the legal heir does not acquire any interest in the property subsequent to his acquiring the same.

To put it in simple words, in case a charge or mortgage on the property has been created by the previous owner and on death, such property devolves to the legal heir, then the legal heir does not receive an absolute right in the entire property and his interest is limited. But the death of the previous owner would not free the property from the abovementioned charge or obligation and the legal heir would inherit the property subject to the charge created by way of an attachment. For the above principle, one may refer to the decision of the Hon'ble Supreme Court in the case *R.M. Arunachalam vs. CIT [1997] 227 ITR 222* and the Hon'ble *Kerala High Court in the case of Sarala Devi K. vs. CIT [1996] 222 ITR 211.*

Considering the above position, it can certainly be said that the legal heir, in whom a tainted property devolves, cannot be said to have received the entire consideration as a result of the transfer such tainted property. A piece of the pie can be said to have been used to discharge the mortgage debt. This shows that that in such case, there exists an overriding title in favour of another person and the income earned never reaches the legal heirs. Accordingly, income received on transfer of such property, to the extent it is used for discharging a mortgaged debt, cannot be considered as income for the legal herin and thus, cannot be taxed in their hands.

Whilst on the subject, it will be worth discussing a few decisions which seem to have held contrary to the above position. First, he decision of the Hon'ble Bombay High Court in the case of CIT v. R. M. Hussein Merchant [2005] 275 ITR 231 though had a similar fact pattern to the above scenario, however it does not deal with the question of 'income diverted at source by overriding title' and therefore, cannot be used to negate the above contention. Second, the Mumbai Bench of the Hon'ble Income Tax Appellate Tribunal in the case of ACIT v. Meher Rusi Dalal (ITA No. 4569/ Mum-2009 decided on 28.09.2011), under similar facts, has dismissed the claim of the assessee that there was a diversion of income by overriding title. However, with outmost respect, it is contended that the question acquiring absolute interest in the title of the property as compared to an imperfect title, is of paramount significance, which seems to have lost sight of by the Tribunal. In fact, the Hon'ble Supreme Court in the case of R. M. Arunachalam (supra) has in no uncertain words held that the position in law is different if a legal heir receives a property, under a will, which is already subjected to a charge by the previous owner. Therefore, under these circumstances, this decision too does not deal with the question of whether, on transfer of a mortgaged property, an amount which may be paid or parted with to release the charge or mortgage and acquire an absolute interest in the property can be consider diversion of income by overriding title.

If not diversion by Overriding Title, whether the application of income can be claimed as a deduction?

When an appropriation of income is held to be merely an 'application' as against 'diversion, the natural question that arises in the minds is whether such application can be claimed as a deduction from the total income of an assessee in whose hands the said income is taxed.

The answer to this would perhaps lie in the provisions of the respective heads where such an income is taxed in the hands of an assessee. Say an income is taxed under the head 'Profits and Gains from Business and Profession', then the application of that income whether allowable as a deduction from the business / profession income of the assessee shall be governed by the provisions of sections 28 to 37 of the Act. One will have to see whether the conditions of those sections are met with before claiming such application of income as a deduction. For example, to claim a deduction under section 37(1) of the Act, one will have to check if the application of income was incurred 'wholly and exclusively for the purpose of business or profession' or whether the same constituted 'business loss' under section 28 of the Act.

The following are few instances where such application of income was allowed to be claimed as a deduction from the business income of an assessee:

(i) *CIT vs. New India Sugar Mills Ltd. [1994] 206 ITR 212 (Cal.) – SLP dismissed in SLP (Civil) 995 of 1994*

(ii) *CIT vs. Upper Ganges Sugar Mills Ltd. [1994] 72 Taxman 37 (Cal.)*

(iii) *CIT vs. Pandavapura Sahakara Sakkare Karkhane Ltd. [1993] 201 ITR 56 (Kar.)*

(iv) *CIT vs. Dharma Production Private Limited [2017] 248 Taxman 465 (Bom.)*

Reference can also be made to the decision of the Hon'ble Bombay High Court in the case of *Colaba Central Co-op. Consumers' Wholesale & Retail Stores Ltd. vs. CIT [1998] 229 ITR 209* wherein the High

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Court denied the claim of deduction of business expense (which was held to be application of income) on the ground that condition of section 37 of the Act were not complied with as the assessee in that case had not incurred any "expenditure". Therefore, one has to see if the prerequisites of the respective provisions are complied with in order to claim a deduction of that application of income which is taxed in the hands of an assessee.

While determining the allowability of deduction, the question of voluntary or involuntary payments will not arise, since the claim of expenses will strictly be subject to the requirements of the provisions under which such a claim is made. For example, continuing the above illustration of section 37 of the Act, it is well-settled that the expression "wholly and exclusively" used does not mean "necessarily". Ordinarily it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and it is incurred for promoting the business and to earn profits, the assessee can claim deduction even though there was no compelling necessity to incur such expenditure. See *Sassoon J. David & Co. Private Limited vs. CIT [1979] 118 ITR 261 (SC).*

Principles of 'commercial expediency', as echoed by Hon'ble Supreme Court in *S. A. Builders Ltd. vs. CIT(A) [2007] 288 ITR 1* will also govern the claim of deduction of the 'application of income', if the same is taxed under the head 'Profits and Gains from Business or Profession'.

Whilst on this subject, it will be worthwhile to look at a recent decision of the Hon'ble Karnataka High Court in the case of *PCIT vs. Chamundi Winery & Distillery [2018] 408 ITR 402.* It was held that 'distributable surplus' paid to an Indian subsidiary of UK based liquor company under an agreement, whereby the assessee (an Indian entity) agreed to manufacture and sell alcoholic products under control and supervision of Indian subsidiary was an 'application of income' by assessee. To come to this conclusion, the High Court heavily relied upon the arrangement between the parties. Interestingly, it also rejected the alternate plea of the assessee of allowing the application of income as business loss or expenditure under section 28 or 37(1) of the Act in the following manner:

"28. We cannot appreciate the argument of the learned counsel for the assessee that if it is not a case of 'diversion of income at source', it should be allowed as a 'business expenditure' under Section 37 of the Act or as a trading loss under Section 29 of the Act.

29. It is opined that the 'diversion of income at source' and 'business expenditure' under section 37 are contradiction in terms and both contradictory claims cannot be made by the assessee even in the alternative. The 'diversion of income' or rather 'distribution of surplus' under the Agreement dated 30-10-2007 required to be made by the assessee to Diageo India is only after the income is brought to tax in the hands of the respondent assessee and therefore the 'distributable surplus' which the assessee has debited in the Profit and Loss Account and credited to the account of the Diageo India for first four assessment years 2008-09 to 2011-12, cannot be claimed as a 'business expenditure' under section 37. It is nothing but just the 'application of income' by the assessee under the Agreement dated 30-10-2007 which has to be done after payment of due tax under the Income-tax Act which has not been done by the assessee in the instant case.

...

31. The meeting of the contractual obligations by the Respondent Assessee under the said Agreement dated 30-10-2007 is not in the form of expenditure but day-to-day swipe of the Receipts from the business activity but that swipe of Receipts also does not amount to 'diversion of income by overriding title' from CHAMUNDI to DIAGEO.

32. The charge of Income-tax on the income arising and accruing in the hands of the Respondent Assessee CHAMUNDI cannot be allowed to fail either by the manner of bank accounts to be operated or by the entries made in the Books of Account or the method of accounting adopted by the two parties to the contract. Therefore, such 'distributable surplus' made over by the Respondent Assessee CHAMUNDI to DIAGEO is neither an 'allowable expenditure' under Section 37 of the Act nor a 'trade loss' allowable as a deduction in the *hands of the Respondent Assessee CHAMUNDI under Section 29 of the Act, but is merely an 'application of income' or the compensation paid by the assessee to DIAGEO in terms of the Agreement dated 30-10-2007."*

At first blush, one can be intrigued by the above findings of the court that *"the 'diversion of income at source' and 'business expenditure' under section 37 are contradiction in terms and both contradictory claims cannot be made by the assessee even in the alternative"*. The above conclusions seem to be contrary to the well-settled law that a revenue expense which has been incurred by an assessee wholly and exclusively for the purpose of its business is allowable as a deduction from the business income of that assessee.

However, as one reads the finer text of the judgment, it become clear that the High Court was indeed swayed by the peculiar facts and circumstances of the case when it concluded that the payment to 'Diageo' was 'application of income' and the expenditure was not allowable in the hands of the assessee.

In no uncertain words has the Court held that it concluded so on the basis of the arrangement between the parties, which, in the opinion of the court, was a device created to avoid tax, and thus, such a claim of expenditure was been denied. But for such an arrangement between the parties, the claim for expenditure was allowable under section 28 / 37 of the Act. The Court accepted the legality of the arrangement between the parties, but while deciding taxability of the income and allowability of expenditure, pierced into the agreement for examining the overall and real purpose of such an arrangement, which in that case, was considered a tool for tax avoidance and thus, disregarded the same. The relevant extract of the decision is as under:

> *"67. As we have already indicated above, had CHAMUNDI paid the royalty, finance charges, cost of raw materials, etc. to DIAGEO, then these expenses could naturally be allowed as 'business expenses' but in the present case, instead of taking these specified charges, the DIAGEO has taken the whole of the profits leaving the margin of only ₹ 45/- per Case for CHAMUNDI and this, in our opinion, was more a device for tax avoidance rather than amounting to a "diversion of income by overriding title at source". Such a contract even though legally permissible, can be pierced and looked into by the Courts for seeing the overall and actual purpose beyond such facade."*

Conclusion

The above snippet of the doctrine of 'diversion of income by overriding title' and 'application of income' proves that there is no "certainty" when it comes to levy of income tax in India. The question whether an income is 'diverted by overriding title' or 'applied' cannot be answered with a straitjacket formula and each case has to be decided based on its own merits. Every fact has to be carefully examined before giving it a blessing of diversion of income by overriding title at source. The utmost significant factor in deciding a case on such an issue is to see, as formulated in *Sitaldas Tirathdas (supra)*, whether the income had at all reached the assessee or whether the same was diverted at the source itself. The fact that the assessee was legally or statutorily obliged to part with such an income by itself cannot be a criterion to decide this question. The nature of obligation is also significant factor to conclude.

Going Forward

Litigation on the subject doctrine in future cannot be ruled out. Not only is this topic inherently controversial and otherwise susceptible to litigation, but with provisions of Chapter X-A (dealing with 'General Anti-Avoidance Rule', commonly known as 'GAAR') coming into force, each case of taxpayers is prone to be examined microscopically by the Income-tax officers, with 'real purpose' of the transactions likely to be questioned at every stage.

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Relevant Legal Concepts

DOCTRINE OF BINDING PRECEDENT & STARE DECISIS / RATIO DECIDENDI & OBITER DICTA AND RES JUDICATA ; EFFECT OF DISMISSAL OF SLP : (AS APPLICABLE TO TAX LAW)

The Indian Legal System

1. The Indian legal system is the product of history. It is rooted in our soil; nurtured and nourished by our culture, languages and traditions; fostered and sharpened by our genius and quest for social justice; reinforced by history and heritage inspired and strengthened by English Law guided and enriched by concepts and precepts of justice, equity and good conscience which are indeed the hallmarks of the common law.

Doctrine of Binding Precedent

2. The doctrine of binding precedent has merit of promoting certainty and consistency in judicial decisions and enables an organic development of law 'besides providing assurance to an individual as to the consequence of transaction, forming part of his daily affairs. *UOI vs. Raghubir Sing 178 ITR 548 (SC)*

3. As per the doctrine of precedent, all lower Courts, Tribunals and authorities exercising judicial or quasi-judicial functions are bound by the decisions of the High Court within whose territorial jurisdiction these Courts, Tribunals & authorities function. *CIT vs. Thana Electricity Supply Ltd. (1994) 206 ITR 727 (Bom.). Consolidated Pneumatic Tool Co. (India) Ltd. vs. CIT (1994) 209 ITR 277 (Bom.).*

Doctrine of Stare Decisis

4. '*Stare **decisis***' is a Latin phrase which means 'to stand by decided cases' or 'to uphold precedents'. Doctrine of *stare decisis* is a general maxim which states that when a point of law has been decided, it takes the form of a precedent which is to be followed subsequently and should not normally be departed from.

By **virtue** of Article 141 of the Constitution of India, the judgments pronounced by the Supreme Court have the force of law and are binding on all the Courts in India. However, the Supreme Court itself is free to review its earlier decision and depart from it if the situation so warrants.

5. The Madras High Court in *Peirce Leslie & Co. vs. CIT [1995] 216 ITR 176 (Mad.)* observed that the doctrine of *stare decisis* is one of the policy grounded on the theory that security and certainty require that accepted and established legal principles, under which rights may accrue, be recognised and followed, though later found to be not legally sound, but whether a previous holding of the Court shall be adhered to or

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modified, or over-ruled, is within the Court's discretion under the circumstances of a case before it.

Income-tax Act, being a Central Act of Parliament, uniformity of construction by the various High Courts should be followed unless there are overriding reasons for taking a divergent view.

6. If the revenue has not challenged the correctness of the law laid down by the High Court and has accepted it in the case of one assessee then it is not open to the Revenue to challenge its correctness in the case of other assessee without just cause.

- *UOI vs. Satish Panalal 249 ITR 221 (SC)*
- *UOI vs. Kaumudini N. Dalal 249 ITR 219 (SC)*
- *CIT vs. J. K. Charitable Trust (2008) 308 ITR 161 (SC)*
- Difference between "Res Judicata" and "Consistency Principle" explained.

While *"res judicata"* does not apply to income-tax matters, the principles of consistency does. If the Revenue has accepted a practice and consistently applied and followed it, the Revenue is bound by it. The Revenue can change the practice only if there is a change in law or change in facts and not otherwise

PCIT vs. Quest Investment Advisors Pvt. Ltd, ITA no. 280 of 2016, dtd: 28-6-2018 (Bombay High Court)

7. The Supreme Court in *Sakhi vs. Union of India AIR 2004 SC 3566 at 3577* observed : "*Stare decisis* is a well-known doctrine in legal jurisprudence. The doctrine of *stare decisis*, meaning to stand by decided cases, rests upon the principle that law by which men are governed should be fixed, definite and known, and that, when the law is declared by Court of competent jurisdiction authorised to construe it, such declaration is absence of palpable mistake or error, is itself evidence of the law until changed by competent authority. It requires that rules of law when clearly announced and established by a Court of last resort should not be disregarded and set aside but should be adhered to and followed. What it precludes is that where a principle of law has become established by a series of decisions, it is binding on the Courts and should be followed in similar cases. It is a whole-some doctrine which gives certainty to law and guides the people to mould their affairs in future".

Ratio Decidendi

8. *Ratio decidendi* is a Latin phrase meaning "the reason" or "the rationale for the decision". The *ratio decidendi* is "the point in a case which determines the judgment" or "the principle which the case establishes". In other words, *ratio decidendi* is a legal rule derived from, and consistent with, those parts of legal reasoning within a judgment on which the outcome of the case depends.

9. The substance of the above expression means the reasons given by the Court or Tribunal for deciding the issue and not every observation. The judicial view on this subject is as under:

"The underlying principle of a judicial decision which forms its authoritative element for the future, is termed *ratio decidendi.* It is contrasted with an *obiter dictum* or that part of a judgment which consists of the expression of the judges opinion on a point of law which is not directly raised by the issue between the litigants." [Stephen Commentaries (Vol. I p. 11)] — referred to in *CWT vs. Dr. Karan Singh (1993) 200 ITR 614 (SC).*

The expression *'ratio decidendi'* means the reasons given by the court for deciding the issue before it. Where two reasons are given for arriving at a particular decision then, both reasons would form the *ratio decidendi* for the said decision and both reasons would be binding. *Fibre Boards (P.) Ltd vs. CIT(2015) 376 ITR 596 (SC)*

10. It is well-settled that a decision as an authority for what it actually decides. What is of the essence in a decision is its ratio and not every

observation found therein nor what logically follows from the various observations made therein…It would, therefore, be not profitable to extract a sentence here and there from the judgment and to build upon it because the essence of the decision is its ratio and not every observation found therein….The enunciation of the reason or principle on which a question before a Court has been decided is alone binding between the parties to it, but it is the abstract *ratio decidendi*, ascertained on a consideration of the judgment in relation to the subject matter of the decision, which alone has the force of law *[UOI vs. Dhanwanti Devi (1996) 6SCC 44]*

At this juncture, I would like to refer the decision of the Hon'ble Apex Court in *CIT vs. Sun Engineering Works (1992) 198 ITR (SC)* wherein the court observed "while applying the decision to later cases, the Court must carefully try to ascertain the true principal laid down by the decision of the Supreme Court and not to pickout words or sentences from the judgment divorced from the context of question under consideration by the Court to support their reasoning."

Thus, it is clear that it is the ratio of the decision which must be ascertained by the Court/Tribunal before applying the same.

11. In case of *Iskrareco Regent Ltd. vs. CIT (2011) 313 ITR 317 (Mad.)(High Court)* it was held that judgment cannot be read like a statute. Courts should not place reliance on decision without discussing factual situation involved in the said decision and how it would apply to the facts involved in the subsequent case. A ratio laid down by a higher forum should not be taken out of context and construed like a statute.

12. It is also well-settled that the judgment of the Hon'ble Supreme Court or the High Court must be read as a whole and the observations from the judgment have to be considered in the light of the question, context and the facts of that case. It is neither desirable nor permissible to pick out a word or a sentence from the judgment of the Hon'ble Apex Court, divorced from the context of the question under consideration and treat it to be the complete law laid down by the Hon'ble Court. It is also equally well-settled that a decision is to be followed for what it actually decides and not necessarily for what logically follows from it.

ACIT vs. Affection Investments Ltd. (2003) 80 TTJ 278 / (2004) 2 SOT 165 (Ahd.)(Trib.)

Binding nature of order of one Bench of Tribunal on another Bench

13. A decision of a Division Bench and Third Member Bench is binding on the Single Member Bench. A decision of a Special Bench is binding on all the Benches of the Tribunal. A decision of the Special Bench can be distinguished or disregarded if there is any contrary view of the jurisdictional High Court or of the Supreme Court. A co-ordinate Bench should follow the view of another co-ordinate Bench or else refer the matter to a larger Bench through the President.

14. For the sake of uniformity, one Bench of the Tribunal is bound to follow the view expressed by another Bench of the Tribunal unless the earlier view is *per incurious – CIT vs. L. G. Ramamurthi 110 ITR 453 (Mad.) ; CIT vs. S. Devaraj 73 ITR 1 (Mad.).*

15. Tribunal should not come to a conclusion totally contradictory to the conclusion reached by the earlier Bench of the Tribunal. Where a Bench differs from an earlier Bench, the matter should be referred to a larger Bench – *CIT vs. Goodlass Nerolac Paints Ltd. 188 ITR 1 (Bom.). UOI vs. Paras Laminates Pvt. Ltd. (1990) 186 ITR 722 (SC); Pradip Chandra Parija vs. Pramod Chandra Patniak (2002) 254 ITR 99 (SC).*

16. One Bench cannot differ from the view of another co-ordinate Bench. *Mercedes Benz India Pvt. Ltd. vs. UOI (2010) 252 ELT 168 (Bom.)*

ITO vs. Baker Technical Services Pvt. Ltd. (2010) 125 ITD 1 (Mum.)(TM)

17. In case of *Hatkesh Co-op Housing Soceity Ltd. vs. ACIT (Bom.)(HC);* www.itatonline.org the court observed that when an identical issue, which had earlier arisen before the co-ordinate Bench of the Tribunal on identical facts and a view has been taken on the issue then judicial discipline would demand that a subsequent Bench of the Tribunal hearing the same issue should follow the view taken by its earlier co-ordinate Bench. No doubt this discipline is subject to the well-settled exceptions of the earlier order being passed per *incurim* or *sub silentio* or in the meantime, there has been any change in law, either statutory or by virtue of judicial pronouncement. If the earlier order does not fall within the exception which affects its binding character before a co-ordinate bench of the Tribunal, then it has to follow it. However, if the Tribunal has a view different than the view taken by its co-ordinate Bench on an identical issue, then the order taking such a different view must record its reasons as to why it does not follow the earlier order of the Tribunal on an identical issue, which could only be on one of the well-settled exceptions which affect the binding nature of the earlier order. It could also depart from the earlier view of the Tribunal if there is difference in facts from the earlier order of co-ordinate Bench but the same must be recorded in the order. The impugned order is blissfully silent about the reason why it chooses to ignore the earlier decision of the Tribunal rendered after consideration of Sind Co-op. Hsg. Society (Bombay High Court), and take a view contrary to that taken by its earlier Co-ordinate Bench. It is made clear that in case a subsequent bench of the Tribunal does not agree with the reasons indicated in a binding decision of a co-ordinate Bench, then for reasons to be recorded, it must request the President of the Tribunal to constitute a Larger Bench to decide the difference of view on the issue.

Non-Consideration of decision citied of the Co-ordinate Bench amounts to mistake apparent on record as held in *Honda Siel Power Products Ltd. vs. CIT (2007) 295 ITR 466 (SC).*

18. **Special Bench decision of three members should have precedence over Third Member decision.**

Oman International Bank 286 ITR 8 (AT)(SB). Third Member decision is like the decision of special Bench should be followed in same manner.

Binding nature of orders of Tribunal

19. The First Appellate Authority or the Assessing Officers are bound by the orders of the Tribunal. Even where the assessee or the department has pursued the matter in reference proceedings, it does not act as a kind of stay of operation of the order of the Tribunal.

20. The Assessing Officer cannot ignore the decision taken by the Tribunal in favour of the assessee and take a contrary view – *ITO vs. Siemens India Ltd. & Another 156 ITR 11 (Bom.). Bank of Baroda vs. H.C. Shrivastava (2002) 256 ITR 385 (Bom.).*

21. The Assessing Officer cannot refuse to follow the order passed by the Commissioner against the application u/s. 132(11) on the ground that the Commissioner had no jurisdiction over the matter – *Union of India vs. Pradip Kumar Saraf & Others 207 ITR 679 (Cal.), Sree Rajindra Mills Ltd. vs. CIT (1970) 28 STC 483; Union of India vs. Kamlakshi Finance Corpn. Ltd. 1992 AIR SC 711 (712) Sub-Inspector Rooplal & Anr. vs. Ltd. Governor & Ors. (2000) 1 SCC 644. ; Gammon India Ltd. vs. Commissioner of Customs (2011) 10 GSTR 134 (SC); Nirma Ltd. vs. Commissioner of Central Excise, Ahmedabad 2012 (276) ELT 283 (Trib.) (Ahd.)*

22. It is neither permissible nor legal for any Court and Tribunal to comment upon the decision of the Supreme Court/High Court. Similarly, it is also not permissible for the Tribunal to comment upon the manner in which a particular decision was rendered by the Supreme Court/High Court. It is also not permissible for the Tribunal to sidetrack or/and ignore the decision of the High Court on the ground that it did not take into consideration a particular provision of law. If such

an approach is resorted to by subordinate Courts/ Tribunals, then it is held to be not in conformity with the law laid down by the Supreme Court. It was deprecated by the Supreme Court as being improper.

National Textile Corporation Ltd. vs. CIT (2008) 338 ITR 371 / 5 DTR 117 (MP)(High Court)

23. The Hon'ble Bombay High Court in *CIT vs. Thana Electricity Supply Ltd. 206 ITR 727 (738-739)* after considering various judgments of Supreme Court laid down the following propositions with regard to binding precedent:

(a) The law declared by the Supreme Court being binding on all Courts in India, the decisions of the Supreme Court are binding on all Courts, except, however, the Supreme Court itself which is free to review the same and depart from its earlier opinion if the situation so warrants. What is binding is, of course, the ratio of the decision and not every expression found therein.

(b) The decisions of the High Court are binding on the subordinate Courts and authorities or Tribunals under its superintendence throughout the territories in relation to which it exercises jurisdiction. It does not extend beyond its territorial jurisdiction.

(c) The position in regard to the binding nature of the decision of High Court on different Benches of the same court may be summed up as follows:

i) A Single Judge of High Court is bound by the decision of another single Judge or a Division Bench of the same High Court. It would be judicial impropriety to ignore that decision. Judicial comity demands that a binding decision to which his attention had been drawn should neither be ignored nor overlooked. If he does not find himself in agreement with the same, the proper procedure is to direct the papers to be placed before the Chief Justice to enable him to constitute a larger Bench to examine the question (see, *Food Corporation of India vs. Yadav Engineering & Contractor, AIR 1982 SC 1302).*

ii) A Division Bench of High Court should follow the decision of another Division Bench of equal strength or a Full Bench of the same High Court. If one Division Bench differs from another Division Bench of the same High Court, it has to refer and transfer the case to a larger Bench.

iii) Where there are conflicting decision of courts of co-ordinate jurisdiction, the later decision is to be preferred if reached after full consideration of the earlier decisions.

d) The decision of the High Court is binding precedent neither for another High Court nor for courts or Tribunal outside its own territorial jurisdiction. It is well-settled that the decision of a High Court will have the force of binding precedent only in the State or territories over which the Court has jurisdiction. In other States outside the territorial jurisdiction of that High Court it may, at best, have only persuasive effect. By no amount of stretching of the doctrine of *stare decisis*, can judgments of one High Court be given the status of a binding precedent so far as other High Courts or Courts or Tribunals within their territorial jurisdiction are concerned. Any such attempt will go counter to the very doctrine of *stare decisis* and also the various decisions of the Supreme Court which have interpreted the scope and ambit thereof. The fact that there is only one decision of any one High Court on a particular point or that a number of different High Courts have taken identical views in that regard is not at all relevant

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of that purpose. Whatever may be the conclusion, the decisions cannot have the force of binding precedent on other High Courts or on any subordinate Courts or Tribunals within their jurisdiction. That status is reserved only for the decisions of the Supreme Court which are binding on all courts in the country by virtue of Article 141 of the Constitution.

[CIT vs. Thana Electricity Supply Ltd., (1994) 206 ITR 727, 7380-39 (Bom). Also see, Consolidated Pneumatic Tool Co. (India) Ltd. vs. CIT (1994) 209 ITR 277, 282 (Bom.)].

Binding nature of High Court decision

24. A High Court must not brush aside the binding precedent or the judgment of a co-ordinate Bench simply beacause some of the arguments were either not canvassed or if canvassed were not considered. The binding precedent can be ignored only if it is *per incurium*

CIT vs. Impact Containers Pvt. Ltd. (2014) 367 ITR 346 (Bom.) (HC)

25. It is clear that when there are conflicting judgments of the jurisdictional High Court, normally the latter judgment would prevail provided it has referred to the earlier decision and distinguished the same. However, if the earlier judgment is not referred to at all, and there are two conflicting judgments, it is open to the Tribunal to follow that judgment, the reasoning of which appeals to the Tribunal. Since both the jurisdictional High Court judgment are binding the Tribunal has to prefer one or the other judgment and in such a case it can prefer either of the two judgments. *Amarsingh Yadav vs. Santi Devi AIR (1987) Patna 191* and *CIT vs. Madhukant M. Mehta (1981) 132 ITR 159 (Guj).*

26. Tribunal has to follow the decision of the jurisdictional High Court without making any comment upon the said decision, it is not permissible for the Tribunal to sidetrack and / or ignore the decision of the jurisdictional High Court on the ground that it did not take into consideration a particular provision of law.

Dy. CIT vs. Gujarat Ambuja Cements Ltd. (2011) 57 DTR 179 (Mum.)(Trib.)

Failure to follow High Court order – *prima facie* amounts to contempt

27. The Sales Tax Officer passed an order refusing to follow the judgment of Bombay High Court in *CST vs. Pee Vee Textiles 26 VST 281* on the ground that the said judgment "is not accepted by the sales tax department and the department has appealed against the same". On a writ petition filed by the assessee, the High Court has taken the view that as the said judgment in *Pee Vee Textiles* is not stayed "the refusal to follow and implement the judgment of this Court by the Sales Tax officer in our considered view *prima facie* amounts to contempt of this Court."

Garware Polyester vs. State of Maharashtra and Ors. Source : www.itatonline.org

28. **Not following binding decision of High Court will amount to "Judicial Indiscipline":**

The ITAT passed an order in *HDFC Bank Limited vs. DCIT (2015) 155 ITD 765 (Mum.)(Trib.)* in which it held that the presumption laid down in *CIT vs. HDFC Bank Ltd. (2014) 366 ITR 505 (Bom.)* and *CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom.)* that investments in tax-free securities must be deemed to have come out of own funds and (ii) Law laid down in *CIT vs. India Advantage Securities Ltd. (2016) 380 ITR 471 (Bom.)* that s. 14A and Rule 8D does not apply to securities held as stock-in-trade cannot be applied as both (2015) propositions are contrary to *Godrej & Boyce Mfg. Co Ltd vs. Dy. CIT (2010) 328 ITR 81 (Bom.).* On a Writ Petition filed by the assessee the Court had reversed the ITAT's order on the ground that it is "Judicial Indiscipline" leading to complete chaos and anarchy in the administration of law. The Court also held that Tribunal to decide it afresh on its own merits and in accordance with law. However the Tribunal would scrupulously follow the decisions rendered by this Court wherein a view has been taken on identical issues arising before it. It is not open to the Tribunal to disregard the binding decisions of this Court, the grounds indicated in the impugned order which are not at all sustainable. Unless the Tribunal follows this discipline, it would result in uncertainty of the law and confusion among the tax paying public as to what are their obligations under the Act. Besides opening the gates for arbitrary action in the administration of law, as each authority would then decide disregarding the binding precedents leading to complete chaos and anarchy in the administration of law. When the assessee has more interest free funds than interest bering funds, presumption is that investment in tax free securities has been made from interest free funds hence no disallowance is permissible. (AY. 2008-09)

HDFC Bank Ltd. vs. DCIT (2016) 383 ITR 529 (Bom.)(HC) Editorial: Order of Tribunal in HDFC Bank vs. Dy. CIT (2015) 155 ITD 765/ 173 TTJ 810/ 130 DTR 21 (Mum.)(Trib.) is set aside.

29. The law **laid** down by the High Court must be followed by all authorities and subordinate Tribunals and they cannot ignore it either in initiating proceedings or deciding the rights involved in such a proceeding. If in spite of the earlier exposition of law by the High Court having been pointed out and attention being pointedly drawn to that legal position, proceedings are initiated, it must be held to be a wilful disregard of the law laid down by the High Court and would amount to civil contempt as defined in section 2(b) of the Contempt of Courts Act, 1971.

Kaira District Co-op. Milk Producers Union Ltd vs. Dy. CIT (2016) 386 ITR 633 (Guj.)(HC)

30. **Binding order – Larger Bench – On Division Bench**

Similarly a division bench of a High Court is fully bound by the view taken by a larger Bench of the Court, regardless of the fact that another High Court prefers a different view. (A.Ys. 2002-03 & 2003-04).

KLM Royal Dutch Airlines vs. ADIT (2007) 292 ITR 49 (Delhi)(High Court)

31. **BINDING NATURE OF HIGH COURT DECISION ON OTHER HIGH COURT**

Although the judgments given by a High Court is not binding on another High Court(s), they hold persuasive value. A High Court when not following another High Court should record its dissent along with the reasons therefore. *Pradip J. Mehta vs. CIT (2008) 300 ITR 231 (SC).*

32. The decision of one High Court is not a binding precedent upon another High Court and at best can only have persuasive value.

Humayun Suleman Merchant vs. CCIT (2016) 387 ITR 421/ 242 Taxman 189/140 DTR 209 (Bom.)(HC)

33. The law laid down by the High Court is binding on all the state.

CIT vs. Raghuvir Synthetics Ltd .(2017) 394 ITR 1 (SC)

Binding nature of non-jurisdictional High Court on Tribunal

34. In the absence of any contrary view, decisions of non-jurisdictional High Court have to be followed by the Tribunal. It is not permissible for the authorities below to ignore the decision of the higher forum on pretext that an appeal is filed in the Supreme Court, which is pending or that steps are to be taken to file an appeal..

Addl. CIT vs. Royal Bank of Scotland N. V. (2011) 130 ITD 305 (Kol.)(Trib.)

35. Judgment of a non-jurisdictional High Court has to be preferred over the judgment of a Special Bench of the ITAT.

Nanubahi D. Desai vs. ACIT (2014) 149 ITD 16 (SB) (Ahd.)(Trib.)

Minda Sai Ltd. vs. ITO (Delhi)(Trib.); www.itatonline.org

Binding nature of Supreme Courts' judgment – Other parties [Arts. 141, 226]

36. In matters arising under public law, when the validity of a particular provision or levy is

challenged, the legal position is that when the Supreme Court declares the law and holds either a particular levy to be valid or invalid it is wrong to contend that the law laid down by the Supreme Court in that judgment would bind only those parties who were before the court and not others in respect of whom appeal had not been filed. To do so would be to ignore the binding nature of a judgment of the Supreme Court under Article 141 of the Constitution of India. To contend that the conclusion reached by the Supreme Court in a case relating to the validity of a levy would apply only to the parties before the Court is to destroy the efficacy and integrity of the judgment and to make the mandate of Article 141 illusory.

U. P. Pollution Control Board & Others vs. Kanoria Industries Ltd. & Anr. (2003) 259 ITR 321 (SC)

Decision of Supreme Court interpreting Excise Act – Not binding in interpreting provisions of Income–tax Act – Object of legislation.

37. While it is true that any law declared by the Supreme Court is one to be followed and applied by all Courts in the country in view of the mandate under Article 141 of the Constitution of India, it is only such law that is declared in a particular context and in respect of the particular statutory provisions and not in general. An interpretation placed on a particular enactment cannot be just engrafted to the provisions of another enactment.

CIT vs. Ecom Gill Coffee Trading P. Ltd. (2014) 362 ITR 204 (Karn.)(HC) CIT vs. B. Fouress P. Ltd. (2014) 362 ITR 204 (Karn.)(HC)

Precedent – Advance Rulings

38. Decision of Advance Ruling Authorities on similar facts in respect of same subject matter can be followed.

DIT vs. Dun and Bradstreet Information Services India P. Ltd. (2011) 338 ITR 95 (Bom.)(High Court)

39. Similarly the Andhra Pradesh High Court held that the Advance Ruling Authorities order under section 67(4)(11) was binding not only on the applicant but also similar situated other dealers.

Tirupati Chemicals, Vijaywada & Anr. vs. Dy. Commercial Tax Officer (2011) 52 APSTJ P. 48 (AP) (High Court)

Doctrine of "Prospective Overruling"

40. **A judicial decision acts retrospectively.** According to Blackstonian theory, it is not the function of the Court to pronounce a "new rule" but to maintain and expound the "old one". In other words, judges do not make law they only discover or find the correct law. The law has always been the same. If a subsequent decision alters the earlier one, it (the later decision) does not make new law. It only discovers the correct principle of law which has to be applied retrospectively. To put it differently, even where an earlier decision of the court operated for quite some time, the decision rendered later on would have retrospective effect clarifying the legal position which was earlier not correctly understood.

41. It is no doubt true that the Court has accepted the doctrine of "prospective overruling". It is based on the philosophy; "the past cannot always be erased by new judicial declaration". It may, however, be stated that this is an exception to the general rule of doctrine of precedent. (A.Y. 1996-97).

ACIT vs. Saurashtra Kutch Stock Exchange Ltd. (2008) 305 ITR 227 SC

42. Normally, a decision of the Supreme Court enunciating a principle of law is applicable to all cases irrespective of the stage of pendency, because it is assumed that what is enunciated by the Supreme Court is in fact, law from inception. It is for the Supreme Court to indicate whether the decision in question will operate prospectively. In other words, there shall be no prospective overruling unless it is so indicated in the particular decision.

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Murthy M. A. vs. State of Karnataka & Others (2003) 264 ITR 1 (SC)

43. It is axiomatic that a decision of the Supreme Court does not make the law but it only declares the law as always existing since its inception.

E.Mark (India) Ltd. vs. CIT (2017) 393 ITR 91 (Bom.) (HC)

Rule of Precedent – And Rule of *Per Incuriam*

44. The discipline demanded by a precedent or the disqualification or diminution of a decision on the application of the *per incuriam* rule is of great importance, since without it, certainty of law consistency of rulings and comity of Courts would become a costly casualty. A decision or judgment can be *per incuriam* if any provision in a statute, rule or regulation, which was not brought to the notice of the Court. A decision or judgment can also be *per incuriam* if it is not possible to reconcile its ratio with that of a previously pronounced judgment of a Co-equal or Larger Bench; or if the decision of a High Court is not in consonance with the views of Supreme Court. The *per incuriam* rule is strictly and correctly applicable to the ratio decidendi and not to *obiter dicta*. *Sundeep Kumar Bafna vs. State of Maharashtra & Anr. AIR 2014 SC 1745.*

When a precedent veases to be binding

45. The Andhra Pradesh High Court in *CIT vs. B. R. Constructions [1993] 202 ITR 222* states that a precedent ceases to have a binding force in the following situations –

(i) if it is reversed or over-ruled by a higher court;

(ii) when it is affirmed or reversed on a different ground;

(iii) when it is inconsistent with the earlier decisions of the same rank;

(iv) when it is sub silentio (non-speaking judgment)

(v) when it is rendered per incuriam (decision decided without referring to a statutory provision or a precedent).

Precedent – Power of Supreme Court to depart from earlier decisions: Constitution of India Arts. 141 and 145 :

46. If a principle laid down by SC is demonstrably inconsistent with the scheme of the Constitution, it becomes the duty of court to correct the wrong principle laid down. It is also the duty of SC to correct itself as early as possible in the matters of the interpretation of Constitution "as perpetuation of mistake will be harmful to public interest".

Desiya Murpokko Dravida Kazhagam & Anr. vs. Election Commission of India (2012) AIR Supreme Court 2191

Binding – Subsequent decision of smaller Bench of Supreme Court – Article 149 of the Constitution of India

47. If subsequent decision of smaller Bench of Supreme Court interpreting decision of larger Bench of Supreme Court is placed before a High Court, latter is bound to follow subsequent decision by smaller Bench which interprets decision of larger Bench because that is interpretation of larger Bench of Supreme Court and High Court cannot make a different interpretation than one made by subsequent decision of Supreme Court which is binding upon it.

CIT vs. Oberoi Hotels (P) Ltd. (2011) 334 ITR 293 (Cal.)(High Court)

Obiter dicta are not Binding

48. Word 'Obiter' means 'by the way', 'in passing', 'incidentally'. *Obiter dictum* is the expression of opinion stated in the judgment by a judge on a question immaterial to the *ratio decidendi*. However, these are of persuasive value. They are unnecessary for the decision of a particular case.

49. In *Mohandas Issardas vs. Santhanam (A.N.) AIR 1955 Bom. 113* it was held that it would be incorrect to say that every opinion of the Supreme Court would be binding on the High Courts. Only the opinion expressed on a question that arose for the determination of a case is binding.

Res Judicata vs. Rule of Consistency

Introduction

1. Finality to assessment facilitates the assessee to plan his affairs and to decide the business planning for long term strategies. However tax authorities feel that there is no finality to any assessment as the principle of *Res Judicata* is not applicable to tax proceedings.

2. The word *'Res Judicata'* is derived from the Latin language. It means a case or suit already decided. The principles of *Res Judicata,* in the eye of law, is that if on any facts and/or law, a particular decision is made then subsequently if any lis on similar facts and/or law is to be decided between the same parties, it should be same as made earlier.

3. As per The Law Lexicon *"Res adjudicata"* means "A matter adjudged; a thing judicially acted upon or decided; a thing or matter settled by judgment; a thing definitely settled by judicial decision, the thing adjudged".

4. Section 11 of The Code of Civil Procedure, 1908, defines *"Res Judicata"* as under:-

"No Court shall try any suit or issue in which the matter directly and substantially in issue has been directly and substantially in issue in a former suit between the same parties, or between parties under whom they or any of them claim, litigating under the same title, in a court competent to try such subsequent suit or the suit in which such issue has been subsequently raised, and has been heard and finally decided by such court."

5. The doctrine of *Res Judicata* is based on three maxims:

i) *Nemo debet lis vaxari pro eadem causa* (no man should be vexed twice for the same cause);

ii) *Interest republicae ut sit finis litium* (it is in the interest of the State that there should be an end to a litigation); and

iii) *Res judicata pro veritate occipitur* (a judicial decision must be accepted as correct).

6. The Bombay High Court, in *H. A. Shah and Co. vs. CIT (1956) 30 ITR 618 (Bom.)* has held that "the principle of estoppel or *res judicata* does not strictly apply to the Income Tax authorities" and yet declaring that:

"An earlier decision on the same question cannot be reopened if that decision is not arbitrary or perverse, if it had been arrived at after due inquiry, if no fresh facts are placed before the Tribunal giving the later decision and if the Tribunal giving the earlier decision has taken into consideration all material evidence."

7. The courts have cautioned that the doctrine of *Res Judicata* should not be stretched too far under direct tax laws. A Tribunal should extremely be slow to depart from its earlier view.

8. In *Radhasoami Satsang vs. CIT (1992) 193 ITR 321 (SC)* the Hon'ble Apex Court observed as under:

"16. We are aware of the fact that strictly speaking res judicata does not apply to income tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year".

9. In the case of *Municipal Corporation of City of Thane vs. Vidyut Metallics Ltd & Anr. (2007) 8 SCC 688,* wherein the facts were that in earlier litigation, the Court had considered the evidence

of Quality control Manager who was described as "expert" on the point and accepting his evidence, the Court held that the goods imported by the company were ferrous in nature and not non ferrous and the company was right in paying octroi under item 71. It was thus a "fundamental factor" and the nature of goods imported by the company was directly and substantially in issue, on the basis of which the decision was taken. The Hon'ble Supreme Court observed that in taxation matters, the strict rule of *res judicata* as envisaged by section 11, CPC 1908 has no application. As a general rule, each year's assessment is final only for that year and does not govern later years, because it determines the tax for a particular period.

The Hon'ble Supreme Court further observed that in facts of present case it was not possible to hold that the earlier decision would not continue to operate in subsequent years unless it is shown that there are changed circumstances or the goods imported by the company in subsequent years was different than the one which was imported earlier and in respect of which decision had been arrived at by the Court. Therefore, it was held that the Revisional Court as well as the High Court were right in giving benefit of the decision in the earlier litigation to the respondent company. The Hon'ble Supreme Court upheld the observation of Supreme Court in case of *Radhaswami Satsang (Supra).*

10. Further principles of *res judicata* not applicable in cases where order is passed without jurisdiction. Hence would not be binding on other party even if no appeal filed against the same.

UOI & Anr. vs. Association of Unified Telecom Service Providers of India & Ors. AIR 2012 SC 1693

11. On going through the various judicial pronouncements following principles emerge:

i) As a general rule principle of *res judicata* or estoppel is not applicable to income-tax proceedings. An assessment of particular year is final and binding in relation to the assessment year in which the decision is given.

ii) In income-tax proceedings though the principle of *res judicata* does not apply, yet rule of consistency does apply i.e., if no fresh facts come to light on investigation, the Assessing Officer is not entitled to reopen the same question on mere ground of suspicion or change of opinion. This is based on principle of natural justice and expediency. The principle of comity lends weight to this preposition.

iii) A finding arrived at in a subsequent year ignoring, without material, the conclusion arrived at earlier would be vitiated in law. There should be no deviation/variation from earlier year's decision unless there are fresh circumstances to warrant a deviation from such previous decision unless it otherwise emerges that the previous decision is wrong.

iv) Principle of *res judicata* or estoppel and principle of consistency or expediency apply with equal force to both Income-tax authorities on one hand and the Tribunal/ High Courts on the other.

v) This principle broadly safeguards the interests of the assessees against arbitrary actions arising out of prerogative interpretations and biased actions.

12. Principle of *res judicata* does not apply in matters pertaining to tax of different assessment years. The reason for following the earlier year decision is not because of principle of *res judicata* but because of theory of precedent. This is subject only to the gateways of distinguishing the earlier decisions and where the earlier decision is *per incuriam.*

Bharat Sanchar Nigam Ltd. & Anr. vs. UOI & Ors. (2006) 282 ITR 273 (SC)

Dismissal of Special Leave Petition

13. A mere dismissal of SLP does not mean that High Court decisions is approved on merits so as to be a judicial precedent. In *Smt. Tej Kumari vs. CIT (2001) 247 ITR 210* Full Bench of the Patna High Court held that when an SLP is summarily rejected or dismissed under Art. 136 of the Constitution such dismissal does not lay down any law. The decision of the High Court against which the SLP is dismissed in limine would not operate as *res judicata*.

However, when Supreme Court dismisses an SLP with reason it might be taken as the affirmation of the High Court views on merits of the case, thus there is no reason to dilute the binding nature of precedents in such cases.

The fact that the Special Leave Petition against the decision of the High Court was dismissed by the Supreme Court would not amount to a confirmation of the view of the High Court.

Palam Gas Service vs. CIT (2017) 394 ITR 300 (SC)

14. Under Article 136 of the Constitution the Supreme Court may reverse, modify or affirm the judgement-decree or order appealed against while exercising its appellate jurisdiction and not while exercising the discretionary jurisdiction disposing the petition for special leave to appeal.

15. The Hon'ble Bombay High Court in the case of *CIT vs. M/s. Pamwi Tissues Ltd. (2008) 3 DTR 66 (Bom.) / 215 CTR 150 (Bom.)* while considering the issue of interpretation of Sec. 43B, 2(24)(x) r/w sec. 36(1)(va) as to the claim of deductions in respect of PF, ESIC Contribution held that the Hon'ble Supreme Court in *CIT vs. M/s. Vinay Cement Ltd.* had dismissed the *SLP, [(2007) 213 CTR 268]* as it was not a fit case for grant of a SLP therefore cannot be said to be the law decided on the subject and it was not a binding precedent as per Article 141 of the Constitution of India.

16. In *State of Orissa & Ors. vs. M. D. Illyas, (2006) 1 S.C.C. 275* the Supreme Court has held that a decision is a precedent on it's own facts and that for a judgment to be a precedent it must contain the three basic postulates. A finding of material facts, direct and inferential. An inferential finding of fact is the inference which the Judge draws from the direct or perceptible facts; (ii) statements of the principles of law applicable to the legal problems disclosed by the facts; and (iii) Judgment based on the individual effect of the above.

17. In *Delhi Administration vs. Madan Lal Nangia AIR 2003 SC 4672* it was held that if an SLP is summarily dismissed, this cannot prevent other parties from filing an SLP against the same judgment.

18. The Supreme Court in *Indian Oil Corporation Ltd. vs. State of Bihar & Ors. (1987) 167 ITR 897 (SC)* has clarified that the dismissal of a Special Leave Petition by the Supreme Court by a non-speaking order would not operate as *res judicata* by observing that- "When the order passed by this Court was not a speaking one, it is not correct to assume that this Court had necessarily decided implicitly all the questions in relation to the merits of the award, which was under challenge before this Court in the Special Leave Petition. A writ proceeding is a wholly different and distinct proceeding. Questions which can be said to have been decided by this Court expressly, implicitly or even constructively while dismissing the Special Leave Petition cannot, of course, be reopened in a subsequent writ proceeding before the High Court. But neither on the principle of *res judicata* nor on any principle of public policy analogous thereto, would the order of this Court dismissing the Special Leave Petition operate to bar the trial of identical issues in a separate proceeding, namely, the writ proceeding before the High Court merely on the basis of an uncertain assumption that the issues must have been decided by this Court at least by implication. It is not correct or safe to extend the principles of *res judicata* or constructive *res judicata* to such an extent so as to found it on mere guesswork".

19. In all cases of admission of the SLP the further decision on merits follows whereas in every case of dismissal there is no question of further decision or proceedings from the Supreme Court and effectively the order of the lower Court/authority which is challenged before the Apex Court is affirmed and becomes final. In such a situation the question whether the person/s aggrieved by the order of the lower Court could agitate his grievance by way of an application for review or rectification of mistakes apparent from record so as to pursuade the lower authority to modify its final order in the light of the application for rectification or review, to the extent and in the manner found appropriate is still open for consideration. The respondent often pleads that the order of the lower Court having been affirmed by the Supreme Court it is no more open to the lower authority, after the dismissal of the SLP to entertain any application and/ or decide the same for the purpose of review, revision or modification of the order which has been upheld by the Supreme Court. The controversy is not free from doubt. The effect of dismissal of SLP by the Supreme Court is that the order of the Supreme Court does not constitute *res judicata* to deny the petitioner the right to agitate matters on merits before the competent Court / Tribunal.

20. Before the Delhi Tribunal Special Bench in the case of *Dy. CIT Circle II Meerut vs. Padam Prakash (HUF) [2009] 117 ITD 129 (Del.)(SB)* the assessee had filed a Miscellaneous Application against the decision of the Special Bench alleging certain mistake in the decision. On the date of hearing it was noticed that the decision of Special Bench was challenged in appeal before High Court u/s. 260A of the Act and the Hon'ble High Court held that the order of Special Bench was not sustainable. In view of the above the Tribunal held that as the Special Bench decision was merged with the order of High Court there was no question of rectification.

21. Similarly where a question has been decided in favour of the assessee or the Department, as the case may be by the High Court, the mere fact that an SLP from the judgment of the High Court is pending before the Supreme Court will not be a ground for allowing an application u/s. 256(2) of the Act, for directing the Tribunal to state the case and refer a question of law to the High Court because, until the question is finally decided by the Supreme Court, the High Court would be bound by its own earlier decision. [See *CIT vs. Desai Brothers Ltd. (1991) 189 ITR 88 (Bom.)* and *CIT vs. Godavari Sugar Mills Ltd. (1992) 198 ITR 196 (Bom.)]*

Effect of dismissal of appeal by High Court holding that no substantial question of law arose

22. Before the Delhi Special Bench in the case of *Medicare Investments Ltd. vs. Jt. CIT Sp. R. 20 (2008) 114 ITD 34* the issue arose for consideration was, whether the decision of Hon'ble Delhi High Court dismissing the appeal filed by the Revenue against the order of the Tribunal passed in the case of *Abhinandan Investment Ltd. & Ors. [2002] 254 ITR 538 (Del.)* holding that no substantial question of law arose, is a decision on merits and constitutes a binding precedent which this Special Bench is bound to follow.

23. The Delhi Special Bench relied on the judgment *Hon'ble Gujarat High Court (2006) 283 ITR 402 (Guj.),* wherein it had been held that dismissal of tax appeal by the High Court holding that no substantial question of law arises implies that the order of the Tribunal on the issue stands merged in the order of the High Court and for all intents and purposes, it is the decision of the High Court which is operative and which is capable of being given effect to. The Hon'ble Gujarat High Court, observed that a plain reading of s. 260A inclusive of sub-sections of the said section makes it clear that the only jurisdictional powers that the High Court can exercise are to hear an appeal and the High Court does not have any powers under the statute to grant any leave as such for filing an appeal. Explaining further, it was observed by their Lordships that the person filing the

appeal is not required to seek any leave from any authority much less the High Court prior to filing of the appeal and it is, therefore, not possible to bifurcate the jurisdiction or powers available to the High Court while dealing with an appeal under s. 260A of the Act.

24. It was held that in all eventualities, what merges is the operative part of the order under appeal after its confirmation, reversal or modification and there would be a merger even in a case where the reasoning of the subordinate forum is not expressly approved. It was held that if the merger is issue-specific, there is fusion of order only to that limited extent but it cannot be successfully contended that where the appellate Court merely accords approval to the reasoning of the lower Court or forum, there is no decision of the appellate Court or forum. It was also clarified by the Hon'ble Gujarat High Court that where the appeal is dismissed on account of being barred by limitation, being defective in nature or the appellant having no *locus standi* to prefer the appeal, the theory of merger of the order of the subordinate forum in the order of the superior forum cannot be applied because there is no "order" made by the superior forum on merits and the controversy between the parties has not been gone into by the appellate forum. It was also held that it is thus not open to any person to contend that there is no decision of the High Court and the subordinate forum is entitled to take a contrary view than the one adopted in the earlier proceedings which has been affirmed by the High Court by a process of dismissal of appeal *simpliciter*.

25. In view of the above Gujarat High Court decision the Special Bench held that Hon'ble Delhi High Court in the case of *Abhinandan Investment Ltd. & Ors. (supra)*, upholding the order of the Tribunal and dismissing the appeal filed by the Revenue on a similar issue holding that no substantial question of law arose, is a decision on merits and since the issue involved in the present case as well as all the material facts relevant thereto, as discussed above, are similar to that of *Abhinandan Investment Ltd. & Ors. (supra)*, the said decision is binding on the subordinate forums within the jurisdiction of Hon'ble Delhi High Court including this Special Bench.

Doctrine of Merger: Speaking & Non-Speaking Order

26. The term merger means to sink or disappear in something else, to become absorbed or extinguished to be combined or be swallowed up. Merger in law is defined as the absorption of a thing of lesser importance by a greater, whereby the lesser ceases to exist. The doctrine is neither a doctrine of Constitutional law nor a doctrine statutorily recognised. It is a common law doctrine founded on the principles of propriety in the hierarchy of justice delivery system.

27. It is a settled law that when the SLP is dismissed, whether by a speaking or non-speaking order whether *in limine* or on contest, second SLP would not lie. However the statement cannot be stretched and applied to hold that such an order attracts applicability of doctrine of merger and excluded jurisdiction of the Court or authority passing the order to review the same.

28. It may be that in spite of having granted leave to appeal, the Court may dismiss the appeal on such grounds as may have provided foundation for refusing the grant at the earlier stage. But that will be a dismissal of appeal. The decision of the Supreme Court would result in superseding the decision under appeal and attract the doctrine of merger. But if same reason has prevailed with the Court for refusing leave to appeal, the order would not have been an appellate order but only an order refusing to grant the leave to appeal.

29. The Supreme Court considered the scope of Article 136 in a case *Kunhayammed vs. State of Kerala (2000) 245 ITR 360 (SC)* where the main issue related to the doctrine of merger and the effect of dismissing a Special Leave Petition by either a speaking or non speaking order. After a brief discussion of the earlier case law on the

subject, the court summarised its conclusions as under:

(i) Where an appeal or revision is provided against an order passed by a Court, Tribunal or any other authority before superior forum and such superior forum modifies, reverses or affirms the decision put in issue before it, the decision by the subordinate forum merges in the decision by the superior forum and it is the latter which subsists, remains operative and is capable of enforcement in the eye of law.

(ii) When the leave to appeal is granted the Special Leave Petition is converted into an appeal.

(iii) An order refusing special leave to appeal may be a non-speaking order or a speaking one. In either case it does not attract the doctrine of merger. If the petition seeking grant of leave to appeal is dismissed, it is an expression of opinion by the Court that a case for invoking appellate jurisdiction of the Court was not made out. Therefore, neither the doctrine of merger nor Article 141 of the Constitution will apply to such a case.

(iv) If the order refusing leave to appeal is a speaking order i.e., gives reasons for refusing the grant of leave, then the order has two implications. Firstly, the statement of law contained in the order is a declaration of law by the Supreme Court within the meaning of Article 141 of the Constitution. Secondly, other than the declaration of law, whatever is stated in the order are the findings recorded by the Supreme Court which would bind the parties thereto and also the Court, Tribunal or authority in any proceedings subsequent thereto by way of judicial discipline, the Supreme Court being the Apex Court of the country.

(v) Once leave to appeal has been granted and appellate jurisdiction of Supreme Court has been invoked the order passed in appeal would attract the doctrine of merger; the order may be of reversal, modification or merely affirmation.

(vi) On an appeal having been referred or a petition seeking leave to appeal having been converted into an appeal before Supreme Court the jurisdiction of the High Court to entertain a review petition is lost thereafter as provided by sub rule(1) of Rule (1) of order 47 of the CPC.

(vii) In spite of a petition for special leave to appeal having been filed, the judgment, decree or order against which leave to appeal has been sought for continues to be final, effective and binding as between the parties. Once leave to appeal has been granted, the finality of the judgment, decree or order appealed against is put in jeopardy though it continues to be binding and effective between the parties unless it is a nullity or unless the court may pass a specific order staying or suspending the operation or execution of the judgment, decree or order under challenge.

30. The Hon'ble Apex Court in case of *V.M. Salgaocar & Bros. P. Ltd. (2000) 243 ITR 384 (SC)* held that when an appeal is dismissed by the Supreme Court by a non-speaking order, the order of the High Court or the Tribunal from which the appeal arose, merges with that of the Supreme Court. In such a case the Supreme Court upholds the decision of the High Court or the Tribunal from which the appeal is provided under clause (3) of Article 133 of the Constitution.

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CA Geeta Jani

Tax Planning, Tax Evasion and Tax Avoidance

The harmonious interplay of the trilogy – Tax planning, tax avoidance and tax evasion

Background

Taxation laws are akin to a double-edged sword, where on one hand, as rightly said by Franklin Roosevelt – *"Taxes, after all, are dues that we pay for the privileges of memberships in an organised society"*, on the other hand, it is a thing often detested by the very honest of the taxpayers as well.

There was a time when taxpayers were reconciled to payment of taxes because such expense was perceived as a consideration for securing welfare of the community, rather than as a dead cost. The reason for the change in attitude of the masses is very well captured by the Supreme Court in the decision of Arvind Narottam [1988] 173 ITR 479 as under:

> *"One would wish, as noted by Chinnappa Reddy, J. in McDowell & Co. Ltd. vs. CTO (1985) 154 ITR 148 (SC), that one could get the enthusiasm of Justice Holmes that taxes are the price of civilisation. But the question, which many ordinary taxpayers very often in a country of shortages with ostentatious consumption and deprivation for the large masses, ask, is, does he with taxes buy civilisation or does he facilitate the waste and ostentation of a few. Unless waste and ostentation in Government spending are avoided, or eschewed, no amount of moral sermons would change people's attitude to tax avoidance."*

While economic planning is the privilege of the State, tax planning is that of the subject. Tax planning, in general sense of the term is undertaken by taxpayers with the primary motive to 'save taxes' i.e., to avoid payment of taxes and enjoy the fruits of their own toil.

Jurisprudentially, avoidance of payment of tax has three facets – Tax evasion, tax avoidance and tax planning. While no formal definitions exist, a cue about the concepts may be derived from the report of The Direct Taxes Enquiry Committee (Wanchoo Committee) which states as under:

> *"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape resorted to. Some are instances of merely*

> *availing, strictly in accordance with law, the tax exemptions or tax privileges offered by the Government. Others are manoeuvres involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. The first represents what is truly tax planning, the latter tax evasion. However, between these two extremes, there is a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact, circumvent it with a view to eliminate or reduce tax burden. It is these methods which constitute "tax avoidance".*

The Calcutta High Court in the case of *Hela Holdings (P.) Ltd. [2003] 263 ITR 129* distinguished between the three concepts in the following manner:

> *"The distinction between tax evasion, tax avoidance and planning is still very much prevalent. Generally speaking, tax evasion is the result of such things as illegality, suppression, misrepresentation and fraud. Tax avoidance is the result of actions taken by the assessee, none of which is illegal or forbidden by the law in itself. But the permissibility of tax avoidance, will to be decided, when and only when, on the basis of facts and transactions truly and correctly disclosed by the assessee, a point of law arises, whether on a certain reasonable construction of a part of the taxing statute, as applied to the assessee's case, tax which otherwise would be payable by the assessee, becomes not payable by him.... The court would here have to draw a line between the three and decide on the basis of the intention of the assessee as to whether the case is that of tax avoidance, evasion or planning."*

Very broadly, what is universally recognised as tax planning is the exercise of claiming, in the spirit of the law, incentives offered by the statute. What is universally considered reprehensible is tax evasion, which signifies avoidance of payment of taxes through blatant violation of law, or through fraudulent means, or, under the shelter of misrepresentation of facts. What was difficult to decipher was the concept of tax avoidance. Some considered the exercise of playing down the impact of law under the shelter of loopholes or ingenious methodology of business arrangements, as a shade of tax planning; some considered it to be an exercise of tax evasion. The challenge lay in defining the stage at which the exercise of tax avoidance becomes an exercise which would be considered by the law or by the judges to be impermissible exercise of tax avoidance.

The latter concept of tax avoidance has enjoyed a long innings of judicial scrutiny across the globe and evolved eventually as discussed in the ensuing paras.

An era of liberal approach to tax planning

The judicial decisions in the beginning of the 20th century, did not generally disapprove of clever tax planning by the taxpayers, so long as they did not fall foul of law. In the year 1926, it was observed in the case of *Fisher's Executors [1926] AC 395 (HL)* as under:

> *"My Lords, the highest authorities have always recognised that **the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or any omissions that he can find in his favour in taxing Acts**. In so doing, he neither comes under liability nor incurs blame."*

Thereafter, this principle was concurred with by Lord Tomlin in 1935, in the case of *Duke of Westminster [1935] (19 TC 490)*, which is believed to be the most authoritative decision on issue of tax avoidance, observing that:

> *"Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, howsoever unappreciative the Commissioners of Inland Revenue of his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax….That a subject, whether poor and humble or wealthy and noble, has the legal right to dispose off his capital and income as to attract upon himself the least amount of tax?"*

Thus, as per the Westminster doctrine, the courts in the west well allowed the tax avoidance tool that was within the periphery of law i.e., avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and certainly not bad morality for a taxpayer to so arrange his affairs in a way to prevent burning of a wider hole in his pocket. It also laid down the cardinal approach that the courts need to have a 'look at' approach and not 'look through' approach.

Similar sentiments were expressed by the Indian Supreme Court in case of *A. Raman & Co. [1968] 67 ITR 11* stating that:

> *"The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrues to him….Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon consideration of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented."*

Early signs of departure from liberal approach to tax planning/avoidance

A significant departure from the Westminster doctrine was made in the *House of Lords decision of Ramsay [1982] AC 300*. This decision gave rise to the doctrine of fiscal nullity, observing that the tax consequence of the interlocking, interdependent and pre-determined transactions are to be judged by reference to their substance and not merely the legal form. According to the court, the tax administration cannot be compelled to look at a document/transaction, in blinkers i.e. isolated from the context to which it properly belonged. Thus, a purposive approach was propagated unlike *Westminster's* doctrine requiring to give legal form a precedence.

The winds of change swept Indian mainland as well, if the decision of Supreme Court in the case of *McDowell & Co. Ltd. [1985] 154 ITR 148* is any guide. The case law related to Andhra Pradesh sales tax law. The taxpayer, a liquor manufacturer company, had developed a pass system for its wholesale buyers, wherein, under a contractual arrangement, the buyer took over the excise duty liability and made payment of excise duty directly to state excise authorities. Taxpayer (the seller) prepared the sales bill for amount reflecting only liquor price (excluding excise duty). Consequently, taxpayer paid sales tax on basis of turnover sans duty amount, which apparently resulted in lower sales tax collection.

Delivering judgment on behalf of the Full Court, Justice Ranganath Misra observed as under:

> *"Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay*

the taxes honestly without resorting to subterfuges."

Evidently, the main ruling did not disapprove of the concept of tax planning or saving of tax through acceptable arrangement. What all that the Court concluded was that where a colourable device or a subterfuge or dubious methods were employed by taxpayers without presence of any commercial backing and with the sole objective to reduce the tax liability, the Court will not support such an arrangement. This was, in substance, meant to be the 'McDowell spirit'.

Had the judgment been restricted to these observations, the judgment may not have caused the concern which it actually did. The widespread concern arose because of the following observations of Justice Chinappa Reddy, who delivered his separate judgment after having expressed his consent to the aforequoted observations of Justice Ranganath Misra:

> *"We think that time has come for us to depart from the Westminster principle as emphatically as the British Courts have done and to dissociate ourselves from the observations of Shah, J. (in case of Raman & Co.) and similar observations made elsewhere. The evil consequences of tax avoidance are manifold…….. But, surely, it is high time for the judiciary in India too to part its ways from the principle of Westminster and the alluring logic of tax avoidance…..In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax, and whether the transaction is such that the judicial process may accord its approval to it."*

Understandably, the judgment was welcomed by the tax authorities and was being relied upon by them as a magic wand in cases where even if the tax liability of the taxpayer stood reduced as a consequence of an honest, genuine and lawful act, the tax benefit was being denied. It was not realised by the tax authorities that the judgment ought to be restricted to cases of arrangements which involved paperwork or subterfuge which had no commercial impact whatever on the relationship between the parties, and yet the exercise offered tax benefit. It was meant to target insertion of steps or commitments which had no commercial rationale whatever but were inserted for the sole purpose of obtaining tax benefit.

Reaffirmation of the legitimacy of tax planning and significance of legal form of transaction in the matter of interpretation of tax laws

A sign of relief was engulfed on the taxpayers when the Madras High Court[1] in case of *M. V. Valliappan [1988] 170 ITR 238* rationalised the scope of McDowell's doctrine by concluding that it is only when an arrangement or transaction is a colourable device adopted for the sole purpose of evading or avoiding tax liability that the dubious or colourable transaction can be ignored by the Courts.

An overwhelming interpretation of the McDowell case (supra) was observed in the decision rendered by Gujarat High Court in case of *Banyan and Berry [1996] 222 ITR 831:*

> *"In McDowell's case, the Court nowhere said that every action or inaction on the part of the taxpayer which results in*

1. This decision was reversed by the Supreme Court in case of *M.V. Valliappan [1999] 238 ITR 1027* on merits but did not comment on observations of Madras High Court. However the observations of the Madras High Court on the decision of McDowell's (supra) were affirmed by the Supreme Court in case of *Azadi Bacho Andolan [2003] 263 ITR 706.*

> *reduction of the tax liability to which he may be subjected in future, is to be viewed with suspicion and treated as a device for avoidance of tax, irrespective of the legitimacy or genuineness of the act....the principle enunciated in that case has not affected the freedom of the citizen to act in a manner according to his requirements, his wishes in the manner of doing any trade, activity or planning, his affairs with circumspection, within the framework of law, unless the same fall in the category of colourable device which may properly be called a device or a dubious method or a subterfuge clothed with apparent dignity."*

While the carousel was turning in India for tax avoidance principles, there came a decision in West in case of *MacNiven vs. Westmoreland Investments Ltd. [2001] STC 237* by the House of Lords, highlighting that the *Westminster* doctrine and decision in case of *Ramsay* (*supra*) were not irreconcilable and held that Ramsay ruling was not an overriding legal principle superimposed on tax laws without regarding the language of particular provisions of law. It concluded that where steps having no commercial purpose were artificially inserted in a complex transaction for tax benefits, they had to be disregarded, however transactions coming into statutory language could not be disregarded merely because they were entered solely for tax purposes.

Bonanza for taxpayers – Indian Supreme Court judgments in the case of Azadi Bachao and Vodafone –Approach to interpretation of tax cases

In the case of *Azadi Bachao Andolan [2003] 263 ITR 706 (SC),* the Supreme Court was concerned with petition from tax authority praying for grant of treaty benefit to a Mauritius company which was holding tax residency certificate. The question before the Court was whether exemption can be denied under the treaty to a company which was formed in Mauritius with the object of treaty shopping i.e., for the dominant purpose of avoiding tax liability. While the company was legally formed, the dominant purpose which motivated the formation was tax avoidance. The court concluded in favour of the taxpayer and did not regard the motive of treaty shopping to be an unacceptable tax avoidance exercise. Indeed, had it been a case that the Mauritius Company was a mere puppet and did not exist in form, the decision may have been different. But, in context of a validly formed company, the Court did not ignore the legal entity on the basis of an allegation that the intervention was inspired by purpose of tax saving.

There was then an overwhelming conclusion in the judgment of Supreme Court in the case of *Vodafone International Holdings B.V. [2012] 341 ITR 1.* The case pertained to entities forming part of the Hutchison Group. The Court was concerned with share sale transaction undertaken between *Hutchison Telecommunication International Ltd. (HTIL),* a Cayman Islands company and the taxpayer, being a Netherlands tax resident, under which HTIL transferred its stake in its wholly owned subsidiary, CGP Investments (CGP) to the taxpayer. It was revenue's contention that since CGP, through a chain of intermediary subsidiaries, indirectly held stake in an Indian joint venture company, *Vodafone Essar Ltd. (VEL),* and derived its full value from India, the transaction should, in substance, be interpreted as a transaction involving sale of India assets and the consideration accruing to HTIL was, therefore, income deemed to accrue or arise in India and therefore taxable in India.

The Court preferring a 'look at' approach over 'look through' approach, stated that, the transaction should be respected as a transaction of sale of shares of an overseas company and cannot, in derogation of the status of legal entities, be interpreted as a transaction of transfer of India assets merely because the overseas legal entity derived value from India. The legal form of overseas company or the legal form of transaction cannot be ignored by reference to the substance or by urging that the transaction involved clever tax planning.

Specific anti avoidance rules (SAAR)

SAAR represents a specific anti-avoidance rule which forms part of the statute. It is also known as TAAR (Targeted Anti Avoidance Rule), a legal phraseology developed in United Kingdom. It is a provision or a rule which is introduced in the statute to deal with or nullify a mischief or an evil which is noticed by the legislature.

Usually, a SAAR does not prohibit a transaction. But, it defines that a transaction could be considered as being accepted provided it meets with certain parameters or conditions. Looked at alternatively, it seeks to classify the transaction to be an impermissible tax avoidance exercise, unless the transaction meets with defined parameters.

The Income-tax Act, 1961 (ITA) houses multiple SAARs reflected by various provisions like deeming certain distributions as dividends [section 2(22)], capturing offshore gains arising on transfer of assets which derive their value from India [Explanation 5 to section 9(1)(i)], clubbing of income provisions [section 64], disallowance of excessive payments made to related parties [section 40A(2)], dividend and bonus stripping [section 94], etc.

In terms of features, usually, there is a separate SAAR to deal with one specific mischief or evil. It recognises the possibility of taxpayer planning his affairs with the object of tax saving. In the midst thereof, it disables the possibility of positive result in cases where the conditions remain unfulfilled. In the process, it offers certainty of result to taxpayers who fulfil the defined conditions. Once the conditions have fulfilled, the benefit cannot be denied by urging that the underlying intent behind the transaction was to minimise the taxes. Refer following extracts from US Supreme Court in case of *Gregory vs. Helvering [1935] 293 US 465:*

> *"It is earnestly contended on behalf of the taxpayer that since every element required by the statute is to be found in what was done, a statutory reorganisation was effected; and that the motive of the taxpayer thereby to escape payment of a tax will not alter the result or make unlawful what the statute allows.* ***It is quite true that if a reorganisation in reality was effected within the meaning of the statute, the ulterior purpose mentioned will be disregarded.*** *The legal right of a taxpayer to decrease the amount of what otherwise would be his or her taxes, or altogether avoid them, by means which the law permits, cannot be doubted. ... But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended."*

The advent of General Anti-Avoidance Rules (GAAR)

It was realised that the insertion of SAAR was not effective enough to challenge, on a general basis, the transactions or arrangements which were framed with the basic object of tax avoidance. For example, in case of *Walfort Share & Stock Brokers (P) Ltd. [2010] 326 ITR 1 (SC),* the motive of tax avoidance was evident, but since the transaction was within the language of SAAR the Court upheld the result in favour of the taxpayer.

In general, there was a view that a SAAR may not prevent aggressive tax planning to an extent there is an ingenious method of projecting compliance with the conditions specified in the statute. It was also realised that a SAAR can be introduced only after the Government becomes aware of the ingenious practice of the taxpayers. A SAAR can be a reaction to the realisation, but cannot prevent the urge of aggressive tax planning at the threshold. Hence, the legislatures relied on the concept of GAAR, under which the statute defines certain general rules of taxpayer's conduct or behaviour and provides a signal to the taxpayers that the tax administration is powerful enough to question any transaction if it does not meet with the general rules. The rules are subjective in nature and they do therefore serve the purpose of being a preventive measure by inculcating the fear of risk in the mind of the taxpayers.

Indian GAAR – whether restricted to aggressive modes of tax avoidance?

The legislative intent for introduction of GAAR under Indian tax statute does not appear to curb healthy tax planning undertaken by taxpayers to maintain their income hygiene. It also does not appear to shut the window of tax avoidance *per se.* It intends to target the abusive, contrived and artificial arrangements with there being no commercial purpose or rationale to support it.

Such intent is mirrored in the Finance Minister's speech while introducing the Finance Budget 2012, which states:

> *"I propose to introduce a General Anti Avoidance Rule (GAAR) in order to counter aggressive tax avoidance schemes, while ensuring that it is used only in appropriate cases, by enabling a review by a GAAR panel."*

Further, the Explanatory Memorandum to Finance Bill, 2012 also echoes the same legislative intent:

> *"In an environment of moderate rates of tax, it is necessary that the correct tax base be subject to tax in the face of aggressive tax planning and use of opaque low tax jurisdictions for residence as well as for sourcing capital…*
>
> *...In the above background and keeping in view the aggressive tax planning with the use of sophisticated structures, there is a need for statutory provisions so as to codify the doctrine of "substance over form" where the real intention of the parties and effect of transactions and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure that has been superimposed to camouflage the real intent and purpose….It is, therefore, important that Indian taxation law also incorporate a statutory General Anti-Avoidance provisions to deal with aggressive tax planning…*
>
> *…It is accordingly proposed to provide General Anti-Avoidance Rule in the Income-tax Act to deal with aggressive tax planning."*

The Shome Committee's Report also recommends that as one of the overarching principles, every case of avoidance should not be subjected to GAAR unless it is an abusive arrangement.

These sentiments, in fact, resulted in the insertion of provision that an arrangement can be considered as GAAR prone only after it is branded as such by an independent panel of experts.

On a wholesome basis, in my view, it is likely that the court will consider an arrangement to be GAAR tainted only in a case where it sounds aggressive or artificial enough to shock the conscience of the court.

Introduction to the legislative text of GAAR

Under the Indian direct tax statutes, the GAAR provisions were incorporated under Chapter X-A of the ITA with the aim to serve as a deterrent against abusive tax avoidance practices.

The GAAR provisions provide that where the taxpayer has entered into an *'impermissible avoidance arrangement'*, the tax authorities shall be empowered to reconstruct such an arrangement as is reasonable in order to deny the tax benefit.

Tagging of an arrangement as an *'impermissible avoidance arrangement'* requires that such an arrangement be entered with the main purpose of obtaining the tax benefit (main purpose test) and it should be tainted with any of the aforesaid elements, being:

(a) creating rights and obligations amongst the contracting parties, which may not be normally created between person's dealing in arm's length; or

(b) resulting in misuse/abuse of the provisions of tax statute; or

(c) lacking/deemed to lack commercial substance; or

(d) entered into or carried out in a manner not ordinarily employed for *bona fide* purposes.

These four elements may be referred to as constituting the "tainted elements test".

As a primary analysis, an arrangement can be urged to be impermissible only if it can be established by Assessing Officer (AO) that the main purpose behind the arrangement is to obtain the tax benefit. When the existence of arrangement or existence of a step within the arrangement is motivated by a commercial purpose or a commercial reason or a business strategy, it cannot at all be considered impermissible even if it also has the motive of tax saving or even if it results in tax saving. It is only when the existence or insertion of arrangement or a step in the arrangement cannot be justified without reference to tax saving that the provisions of GAAR chapter may be invoked.

In a way, the obtaining of tax benefit is, in itself, a commercial reason for a business enterprise. The desire of improving Expected Time of Return (ETR) or Earnings Per Share (EPS) is a business object of an enterprise. However, for the purpose of testing GAAR, the object of tax saving cannot be put forth as a justifiable commercial purpose.

Interestingly, the purpose of avoiding indirect tax and/or stamp duty and/or taxation in overseas country continues to be regarded as a justifiable commercial purpose, what is sought to be questioned is the object of obtaining tax benefit under Indian Income-tax Act.

As aforesaid, if it can be successfully established that the main object is not to obtain the tax benefit (but, the arrangement is motivated by commercial reasons), the chapter on GAAR has to be completely ignored. But, it is not as if that the arrangement is automatically considered to be GAAR prone merely because the main object is established to be tax saving. Even in such a case, the arrangement is not a GAAR tainted arrangement if it negates all the four pointers of the tainted elements test as stated before.

By way of an exception, GAAR provisions may be invoked only in case of arrangements where the tax benefit arising to all the parties in such arrangement, cumulatively exceeds three crores threshold. Indeed, there also are some other exceptions.

Role of counter factual in establishing the main purpose of a given arrangement

As aforesaid, the taxpayer is keen on urging that the main object behind the arrangement is a commercial purpose, and/or is not tax oriented. The AO has the onus of establishing that the main object was tax benefit.

In the relative battle involving subjective considerations, typically, each party will need to come up with the alternative methods by which the transaction could have been completed by the taxpayer. For example, if the AO raises objections with regard to the methodology adopted by the taxpayer, he will also have the burden of showing it to the panel that the commercial objects could have been as effectively fulfilled by a more simpler alternative method which eliminates tax benefit. On the other hand, taxpayer will like to support that he eliminated certain alternative proposals (and selected the implemented methodology) because, the other alternatives were not as effective enough to provide commercial comfort.

In this behalf, as a comfort to the taxpayer, and correctly so, it has been clarified that a taxpayer who has more than one option under the law to complete the transaction can certainly adopt a method which appeals to him. The discretion cannot be questioned merely because it leaves the taxpayer with a lesser tax burden.

Change in approach in GAAR era

In pre GAAR regime, the law laid down by the Supreme Court in case of *Vodafone International Holdings B.V.* (*supra*) advocated a 'look at' approach, impliedly giving more weightage to legal form of a transaction than substance, barring the cases where the legal form itself is a sham or artifice.

Thus, the tax authorities were guided to 'look at' a transaction as completed and the question to be popped was – "What is the transaction?" and thereafter, determine the consequent tax implications. For example, in the case of *Azadi Bachao* (*supra*), the transaction involved transfer of shares by Mauritius Company. In the pre GAAR era, the examination will be restricted to interpretation of the rules related to taxation of transaction of sale of shares by a Mauritius Company. It was all that can be looked at.

Under the GAAR scenario, it is not the case that the tax authorities are to dispense with the legal form of the transaction, but it is improvised to be inquisitively questioned as - "How and why such a transaction or step thereof is undertaken?". For example, in GAAR regime, questions could be asked as to whether the Mauritius Company was introduced for avoiding tax liability in India, or whether there was any commercial object behind its intervention.

In pre-GAAR regime, no fault can be found if the transaction was structured for the purpose of tax saving. For example, treaty shopping was not considered to be questionable. In GAAR regime, for determination of main purpose, the purpose of obtaining tax deduction or benefit cannot be considered as a justifiable commercial purpose.

In the pre-GAAR regime, the court would have intervened by invoking GAAR only in a case where the sole purpose of transaction was to obtain a tax benefit. In GAAR regime, at the AO level itself, the transaction could be questioned if the main purpose of the transaction is tax saving. The burden of producing evidence will be on the taxpayer so as to enable AO to discharge his onus.

GAAR and SAAR

Since the date of introduction of the GAAR provisions, there has been ambiguity with regard to interplay between GAAR and SAAR. While it is arguable that GAAR should not directly conflict with a feature effectively addressed by SAAR, the subject is bound to involve litigation in the future years.

The Shome Committee Report has recommended that the provisions of GAAR should not apply in presence of SAARs. The relevant extract is reproduced hereunder:

> *"It is a settled-principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes…*
>
> *…In view of the above, the Committee recommends that where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/ element."*

However, ambiguity was instilled by CBDT *vide* its Circular No. 7/ 2017 dated 27th January 2017 (FAQ No. 1), which clarified that the provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in facts and circumstances of the case.

Significance of GAAR in International tax realm

Evolution of GAAR is as an anti-abuse provision. It is not a provision unique to India. There are other countries as well which have introduced such provisions.

The concern of resisting abuse of tax laws is the concern shared by international community. The crusade of BEPS (Base Erosion and Profit Shifting) is a revolution in which all the recognised countries have been participating. The framework of MLI (Multilateral Instrument) is an evolution of this crusade.

One of the most talked about provisions of MLI (being a provision almost universally accepted by all the countries) is a provision styled as PPT (Principal Purpose Test). This test envisages that a source country can deny treaty benefit to a resident of other country should it transpire that the principal purpose for formation and establishment of the entity in the other jurisdiction was for the purpose of obtaining tax benefit. For example, India may deny benefit of India-Ireland treaty to an Ireland company, if it is established that the main purpose why US company established and maintained the Ireland company was for the purpose of obtaining, in India, the benefit of India-Ireland treaty. It is an exercise which is very similar to the one which will be carried out within India under GAAR chapter of ITA.

PPT and GAAR may be considered as complementary provisions. There may also be an overlap. For example, in the above illustration, attempt at denying treaty benefit to Ireland company can be made by invoking GAAR provisions of Indian law as well.

Conclusion

The introduction of GAAR in the domestic law can be considered as the single most significant development in the history of Indian direct tax statute. There is no doubt on the proposition that GAAR will have deterrent impact on the stakeholders and is bound to create a culture of adopting methods of implementation which answer to the business or commercial logic. This is indeed a positive side of the apprehension that this chapter has created for the taxpayers. The greater apprehension is in relation to the intensity with which the chapter may be implemented by tax authorities. Indeed, it is not as if that other countries do not have GAAR. But, the statistics reveal that GAAR has been used sparingly as a weapon of last resort. Will the statistics rolled out by India be as promising? Let us hope and trust that the new India is in making even on the front of tax litigation.

❍❑❍

R. P. Garg, *Advocate*

Concept of Mutuality

General

'No man can make a profit out of himself' is the touchstone of mutuality concept. The concept of mutuality edifices the principle: "A person cannot make a profit from himself". Income is that comes in; when it is derived from sources outside of himself.

Espoused the High Court of Australia in Bohemians Club[1] in 1918, the mutuality concept is that "a man is not the source of his own income ... A man's income consists of moneys derived from sources outside of himself. Contributions made by a person for expenditure in his business or otherwise for his own benefit cannot be regarded as his income ... The contributions are, in substance, advances of capital for a common purpose, which are expected to be exhausted during the year for which they are paid. They are not income of the collective body of members any more than the calls paid by members of a company upon their shares are income of the company. If anything is left unexpended it is not income or profits, but savings, which the members may claim to have returned to them."

From oneself, the concept of mutuality winged to defined mutual benefit groups of people who contribute to a common fund, controlled by the group, for a common benefit. Any amount surplus to that needed to pursue the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable. The receipt by the contributors from that common fund or surplus was not income but a receipt of their own money.

The way an amount received from oneself is not regarded as income and is therefore not subject to tax, it is so by the group for the receipts from members, nor *vice versa* i.e., by members from the group. Any amount surplus to that needed to pursue the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable. Over time, groups which have been considered to have mutual income have included corporate bodies, clubs, friendly societies, credit unions, automobile associations, insurance companies and finance organisations. Mutuality is not a form of organisation, even if the participants are often called members. Any organisation can have mutual activities.

Halsbury Laws of England states the concept as: "Where a number of persons combine

1 (1918) 24 CLR 334: The Bohemians Club vs. The Acting Federal Commissioner of Taxation

together and contribute to a common fund for the financing of some venture or object and will in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators…..Members' clubs are an example of a mutual undertaking; but, where a club extends facilities to non-members, to that extent the element of mutuality is wanting...."

Simon's Taxes on the point says: "It is settled law that if the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore no assessment in respect of the trade can be made."

British Tax Encyclopaedia points out the area of the applicability of the doctrine in three fields. First, it applies to mutual insurance companies; secondly, it applies to certain municipal undertakings and, thirdly, to members' clubs, and mutual associations generally, whether incorporated or unincorporated, except registered industrial and provident societies.

Kanga & Palkhivala culled out from Indian decisions and explains it thus: "The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid'. The Madras, Andhra Pradesh and Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves: it is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar association or used for some charitable objects."

Origin of the concept

Origin of the principle is a stem of Styles[2] when the House of Lords in as long back as in 1889 exempted payments of annuities or of capital sums, by mutual insurance company, on the occurrence of events certain or uncertain as hedged by the mutuality. In the language of Lord Watson while substantiating the doctrine of mutuality: "When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities or of capital sums, to some or all of them, on the occurrence of events certain or uncertain, and stipulate that their contributions, so far as not required for that purpose, shall be repaid to them, I cannot conceive why they should be regarded as traders, or why contributions returned to them should be regarded as profits."

As a matter of fact the concept of mutuality came in a court of law some fourteen years earlier to Styles in *The Glasgow Corporation Waterworks Acts*[3] *vs. IRC (1875) 1 TC 28.* The courts held that the concept of mutuality was based on an association of persons who had joined together, not to derive profits or gains but to achieve, through their mutual contributions, a purpose or benefit in which all members could participate or were entitled to do so. These organisations were established on the basis of a legal relationship between the members that gave rise to mutual rights and obligations by the entity towards its members. It is the nature of the legal relationship and the resulting rights that define the mutual character of the entity.

The House of Lords in South-West Lancashire Association[4] - a mutual insurance association, ruled that where the surplus goes back to the insured, whether in cash or in reduction of his premium or in enhancement of the sum insured or on winding up, it is in essence a mere return

2 (1889) 2 TC 460 (HL): Styles vs. New York Life Ins. Co.

3 (1875) 1 TC 28: The Glasgow Corporation Waterworks Acts vs. IRC

4 (1925) 11 TC 790 (HL) : Jones vs. South-West Lancashire Assn.

of his own money which he has overpaid and is not a profit at all. 'Sooner or later, in meal or in malt, the whole of the association's receipts must go back to the policyholders as a class, though not precisely in the proportions in which they have contributed to them and the association does not in any true sense make a profit out of their contributions'.

The doctrine was reiterated in the case of Ayshire Insurance, another mutual insurance company, with the extended observations that if the transactions are of the nature of mutual insurance, the resultant surplus is not income, whether the transactions are with members or with non-members.[5]

The Privy Council decision in Fletcher[6] and two decisions of the Supreme Court in Royal Western India Turf Club Ltd. and Kumbakonam Mutual Benefit Fund Ltd., though agree with the principle of mutuality, restricted its applicability to associations of non-profit-earning motive. A broad proposition is laid down in these cases is that, if the object of the assessee-company claiming to be a 'mutual concern' or 'club', is to carry on a particular business and money is realised both from the members and from non-members, for the same consideration by giving the same or similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole disclose the same profit-earning motive and are alike tainted with commerciality. In other words, the activity carried on by the assessee in such cases, claiming to be a 'mutual concern' or 'Members' club' is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade/business/transaction and the resultant surplus is certainly profit - income liable to tax.

The principle is cancelled by some specific inclusions in the Income-tax Act deeming an amount received from oneself or mutual group regarded as income, like in section 2(24)(vii) including the income of a mutual insurance company and co-operative society from business of insurance as taxable; in Section 2(24)(viia) taxing the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members; Section 28(iii)/section 2(24)(v) treating income derived by a trade, professional or similar association from specific services performed for its members.

Principles Governing Mutuality

One of the first Indian cases that dealt with the principle is Royal Western India Turf Club Ltd., where the Supreme Court noting the summary grounds of the *dicta* in Styles case (supra) as: "From these quotations it appears that the exemption was based on (1) the identity of the contributors to the fund and the recipients from the fund; (2) the treatment of the company, though incorporated, as a mere entity for the convenience of the members and policyholders, in other words, as an instrument obedient to their mandate; and (3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

(a) Complete Identity between Contributors and Participators

The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial[7]. The identity of the contributors and the participators does not mean that each member

5 (1948) 16 ITR Suppl 80 (HL) : Ayshire Ins. vs. IR

6 (1953) 24 ITR 551(SC): CIT vs. Royal Western India Turf Club Ltd; (1964) 53 ITR 241 (SC): CIT vs. Kumbakonam Mutual Benefit Fund Ltd; (1971) 3 All. ER. 1185 (PC): Fletcher vs. Income-tax Commissioner

7 (1932) 16 TC 430, 448 (HL) : Municipal Mutual Ins. Ltd. vs. Hills

should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid. It is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding-up the surplus will be transferred to a similar association or used for some charitable objects.[8]

The Supreme Court in Royal Western India Turf Club's case[9] on a review laid down that an incorporated company which carries on a business and realises money both from members and from non-members for the same consideration, namely, the giving of the same or similar facilities to all alike in the course of one and the same business carried on by it, cannot be regarded as a mutual concern. In that case, fees for admission to a race-course charged to its members by a company carrying on the business of horse racing, were held to be assessable as much as fees paid by the public for admission to the same race-course, the fact that there was a separate enclosure for members being held to be immaterial.

Bankipur Club's[10] revisit of the mutuality concept concluded that: "Where a number of persons combine together and contribute to a common fund for financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associated together in this way does not give rise to profits which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities which it offers does not affect the mutuality of the enterprise. …If the object of the assessee company claiming to be a 'mutual concern' or a 'club', is to carry on a particular business and the money is realised both from the members and the non-members, for the same consideration by giving the same or similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole, disclose the same profit-earning motive and are alike tainted with commerciality...and the resultant surplus is profit-income liable to tax".

The principle postulates that what is returned is contributed by a member and any surplus in the common fund shall therefore not constitute income but will only be an increase in the common fund meant to meet sudden eventualities. A common feature of mutual organisations in general can be stated to be that the participants usually do not have proprietary rights to their share in the common fund, nor can they sell their share. Cessation from membership would result in the loss of right to participate without receiving a financial benefit from the cessation of the membership[11].

b) Mutual benefit contributions

The second feature demands that the actions of the participators and contributors must be in furtherance of the mandate of the association. In the case of a club, it would be necessary to show that steps are taken in furtherance of activities that benefit the club, and in turn its members. Therefore, in Chelmsford Club (supra), since the club provided recreational facilities exclusively to its members and their guests on "no-profit-no-loss" basis and surplus, if any, was used solely for maintenance and development of the club, the Court allowed the exception of mutuality.

c) Funds expended or returned to themselves

Thirdly, there must be no scope of profiteering by the contributors from a fund made by them

8 (1996) 226 ITR 97 (SC) : CIT vs. Bankipur Club

9 (1953) 24 ITR 551(SC) : CIT vs. Royal Western India Turf Club Ltd.,

10 (1997) 226 ITR 97 (SC) : CIT vs. Bankipur Club: (2000) 243 ITR 89 (SC) : Chelmsford Club vs. CIT

11 (2018) 91 taxmann.com 137 (SC) : ITO vs. Venkatesh Premises Co-op.Society Ltd.

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which could only be expended or returned to themselves. The *locus classicus* pronouncement comes from Rowlatt, J's observations in Richard Evans Co. Ltd.[12] wherein, while interpreting Styles case (supra), he held that if profits are distributed to shareholders as shareholders, the principle of mutuality is not satisfied. He observed: "But a company can make a profit out of its members as customers, although its range of customers is limited to its shareholders. If a railway company makes a profit by carrying its shareholders, or if a trading company, by trading with the shareholders – even if it limited to trading with them – makes a profit, that profit belongs to the shareholders, in a sense, but it belongs to them *qua* shareholders. It does not come back to them as purchasers or customers. It comes back to them as shareholders, upon their shares. Where all that a company does is to collect money from a certain number of people – it does not matter whether they are called members of the company, or participating policy holders – and apply it for the benefit of those same people, not as shareholders in the company, but as the people who subscribed it, then, as I understand the New York case, there is no profit. If the people were to do the thing for themselves, there would be no profit, and the fact that they incorporate a legal entity to do it for them makes no difference, there is still no profit. This is not because the entity of the company is to be disregarded, it is because there is no profit, the money being simply collected from those people and handed back to them, not in the character of shareholders, but in the character of those who have paid it. That, as I understand it, is the effect of the decision in the New York case.

Extension of the concept

The origin of the mutuality is found in the case of a mutual insurance association where the surplus went back to the insured, whether in cash or in reduction of his premium or in enhancement of the sum insured or on winding up, it is in essence a mere return of his own money which he has overpaid and is not a profit at all. 'Sooner or later, in meal or in malt, the whole of the association's receipts must go back to the policyholders as a class, though not precisely in the proportions in which they have contributed to them and the association does not in any true sense make a profit out of their contributions'.[13] In the case of a mutual insurance company or association, if the transactions are of the nature of mutual insurance, the resultant surplus is not income, whether the transactions are with members or with non-members.[14] It was extended to other concerns as well.

a) Section 25 companies centralised treatment facility

The principle was applied to the associations incorporated under Section 25 of the Companies Act, 1956 set up with a view to provide a centralised treatment facility for industrial effluents in view of the inability of each industrial unit to set up a separate effluent treatment facility. The income of the assessee was contributed by its members. The assessee has been formed specifically with the object of providing a common effluent facility to its members. The income is not generated out of dealings with any third party. The entire contribution originates in its members and is expended only in furtherance of the object of the Association for the benefit of the members and was rightly held the surplus so generated falls within the purview of the doctrine of mutuality and was not exigible to tax[15].

b) Co-operative Societies

The Supreme Court upheld applicability of mutuality concept in case of a co-operative society[16] by observing: "Transfer charges, here

12 (1927) 11 TC 790(HL) : Thomas vs. Richard Evans Co. Ltd.

13 (1925) 11 TC 790(HL) : Jones vs. South-West Lancashire Assn.

14 (1948) 16 ITR Suppl 80 (HL) : Ayshire Ins. vs. IR

15 (2010) 328 ITR 362 (Bom): CIT vs. Common Effluent Treatment Plant, (Thane Belapur) Association,

16 (2018) 91 taxmann.com 137 (SC): ITO vs. Venkatesh Premises Co-op..Society Ltd

are payable by the outgoing member. If for convenience, part of it is paid by the transferee, it would not partake the nature of profit or commerciality as the amount is appropriated only after the transferee is inducted as a member. In the event of non-admission, the amount is returned. The moment the transferee is inducted as a member the principles of mutuality apply. Likewise, non-occupancy charges are levied by the society and payable by a member who does not himself occupy the premises but lets it out to a third person. The charges are again utilised only for the common benefit of facilities and amenities to the members. Contribution to the common amenity fund taken from a member disposing property is similarly utilised for meeting sudden and regular heavy repairs to ensure continuous and proper hazard free maintenance of the properties of the society which ultimately enures to the enjoyment, benefit and safety of the members. These charges are levied on the basis of resolutions passed by the society and in consonance with its bye-laws. The receipts in the present cases have indisputably been used for mutual benefit towards maintenance of the premises, repairs, infrastructure and provision of common amenities.

Any difference in the contributions payable by old members and fresh inductees cannot fall foul of the law as sufficient classification exists. Membership forming a class, the identity of the individual member not being relevant, induction into membership automatically attracts the doctrine of mutuality. If a Society has surplus FSI available, it is entitled to utilise the same by making fresh construction in accordance with law. Naturally such additional construction would entail extra charges towards maintenance, infrastructure, common facilities and amenities. If the society first inducts new members who are required to contribute to the common fund for availing common facilities, and then grants only occupancy rights to them by draw of lots, the ownership remaining with the society, the receipts cannot be bifurcated into two segments of receipt and costs, so as to hold the former to be outside the purview of mutuality classifying it as income of the society with commerciality."

c) Mutual Benefit Funds

in 1964 the Supreme Court upheld the concept applicable to Mutual Benefit Funds.[17] It expounds that the essence of mutuality thus lies in the return of what one has contributed to a common fund; that all participators must be contributors to the common fund; that there must be complete identity between the contributors and the participators; and that the arrangement must be of non-trading character. In the case of 'mutual society or concern' (including a Members' club), there must be complete identity between the class of contributors and the class of participators.

The particular label or form by which the mutual association is known, is of no consequence. In substance, the arrangement or relationship between the club and its members should be of a non-trading character. A mutual association is an AOP which agrees to contribute funds for some common purpose mutually beneficial and receives back the surplus left out in the same capacity in which they have made the contributions. Therefore, the capacity as contributors and participants remains the same. They contribute not with an idea to trade but with an idea of rendering mutual help. They receive back the surplus which is left after meeting the expenditure of the association which is incurred for the common purpose in the same capacity in which they have contributed. Thus, they receive back what was really their own. The receipt in their hands is not really a profit as no man can make a profit out of himself, just as he cannot enter into a trade or business with himself.

The conflict that a mutual concern may be held to carry on a business or trade with its members,

17 (1964) 53 ITR 241 (SC) : CIT vs. Kumbakonam Mutual Benefit Fund Ltd.

though the surplus arising from such trade is not taxable income or profit; and the later decision Lord Warrington observing to the effect that a mutual concern cannot be held to carry on 'trade'[18] is seemingly settled by the Supreme Court in Royal Western India Turf Club's case[19] and laid down that an incorporated company which carries on a business and realises money both from members and from non-members for the same consideration, namely, the giving of the same or similar facilities to all alike in the course of one and the same business carried on by it, cannot be regarded as a mutual concern. In that case, fees for admission to a race-course charged to its members by a company carrying on the business of horse racing, were held to be assessable as much as fees paid by the public for admission to the same race-course, the fact that there was a separate enclosure for members being held to be immaterial.

As a general rule, the fact that a mutual association is incorporated as a company would not affect its mutual character or the non-liability of the surplus to tax, for incorporation does not destroy or even impair the complete identity between the contributors and the participatory.[20] Yet in peculiar circumstances of certain cases, incorporation has been held to make a difference and an incorporated company may make a taxable profit out of its own members.

The same association may carry on 'mutual' activities resulting in a non-taxable surplus and also non-mutual activities resulting in taxable profits. Even though the assessee company was formed by certain shopkeepers essentially for the benefit of members, the principle of mutuality was not applicable to interest earned by the assessee on fixed deposits with banks, particularly when various kinds of business could be carried on by the assessee under its memorandum.

d) Voluntary Social Organisation

The principle of those decisions may now be usefully invoked only in cases of mutual concerns engaged in activities other than insurance. The principle of mutuality has been accepted in the case of a voluntary social organisation which received offerings (guru dakshina) from its members.[21]

e) Trade or Professional Associations

Where an association or company trades with its members only and the surplus out of the common fund is distributable among the members, there is no mutuality and the surplus is assessable to tax as profit, the reason being that there is no complete identity between the contributors and the participators since those members who have not contributed to the surplus as customers are nevertheless entitled to participate in the surplus.[22] However, if such an association or company distributes the surplus among the customers as such, there would be complete identity between the contributors and the participators, for only those members would be entitled to participate in the surplus who have contributed to it as customer.[23]

Section 28(iii) enacts that 'income derived by a trade, professional or similar association from specific services performed for its members' shall be taxable as business profits. Under section 2(24)(v), any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional

18 (193216 TC 430,(HL) : Municipal Mutual Ins. vs. Hills

19 (1953) 24 ITR 551(SC): CIT vs. Royal Western India Turf Club Ltd.,

20 (1889) 2 TC 460 (HL) : Stvles vs. New York Life Ins. Co.; (1948) 16 ITR 270 (PC) : English Co-op. Soc vs. C Ag IT; (1997) 226 ITR 97 (SC) : CIT vs. Banikpur Club;

21 (1994) 207 ITR 479 CIT vs. Rastriya Sangh; CBDT Letter No. F. 290/2670/INV dated 19-12-1978

22 226 ITR (1964) 53 ITR 241 (SC) : CIT vs. Kumbakonam Mutual Benefit Fund

23 (1927) 11 TC 790 (HL) : Jones vs. South-West Lancashire Assn.; (1953) 24 ITR 551(SC) : CIT vs. Royal Western India Turf Club

or similar association which otherwise may not be liable to tax in view of the general principles of mutuality. 'Some incomes of approved professional associations or institutions are exempt from tax under section 10(23A)'. Section 44A deals with the case where receipts by a trade, professional or similar association from its members, by way of subscription or otherwise, fall short of the expenditure incurred by the association for the purpose of protecting or advancing the common interests of its members.

f) Co-operative Societies

Apart from special statutory provisions, the liability of a co-operative society to tax depends upon whether it is a mutual concern earning non taxable surplus or whether it is a non-mutual concern earning taxable profits. This may be determined upon the general principles enunciated above. In *English & Scottish Joint Co-op. Wholesale Society Ltd. vs. C Ag FT*, a co-operative society which sold tea grown and manufactured by itself to its members was held by the Privy Council to be a non-mutual concern.

A housing society can be treated as a mutual concern if the requisite tests are fulfilled. Consequently, the transfer fee payable by outgoing members for extension of amenities to members has been held not to be taxable. Applying the principles of mutuality, the amounts paid towards the common amenity fund for repairs as well as non-occupancy charges received by a co-operative society would not be liable to tax.

Irrespective of the question whether a co-operative society is a mutual or a non-mutual concern, certain incomes of co-operative societies are exempt from tax under section 80P. Under section 80Q, prior to its deletion with effect from April 1, 1973, a member of a co-operative society was exempt from tax in respect of any dividends received by him from the society. Under section 2(24)(vii) the profits and gains of any business of insurance carried on by a co-operative society, even if it is a mutual concern, are made taxable in all cases as income and are to be computed in accordance with the rules in the First Schedule. Under section 27(iii) a member of a co-operative society to whom a building or part thereof is allotted or leased under a house building scheme of the society is deemed to be the owner of that building or part of that building is assessable as such.

g) Members' clubs

In all these cases in the decision of Bankipur Club[24], the clubs were found to have received amounts were for supply of drinks, refreshments or other goods as also the letting out of building for rent or the amounts received by way of admission fees, periodical subscription, etc., from the members of the clubs were only for/towards charges for the privileges, conveniences and amenities provided to the members, which they were entitled to as per the rules and regulations of the respective clubs. It has also been found that different clubs released various sums on the above counts only to afford to its members the usual privileges, advantages, conveniences and accommodation. In other words, the services offered on the above counts were not done, with any profit motive, and were not tainted with commerciality. The facilities were offered only as a matter of convenience for the use of the members (and their friends, if any, availing of the facilities occasionally). In the light of the above findings, it necessarily follows that the receipts for the various facilities extended by the clubs to its members, as stated hereinabove, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, cannot be said to be 'a trading activity'. The surplus – excess of receipts over the expenditure – as a result of mutual arrangement cannot be said to be 'income' for the purpose of the Act.

24 (1997) 226 ITR 97 (SC) : CIT vs. Banikpur Club

Where a club provides recreational facilities to its members and their guests and to no one else, and is run on 'no profit no loss' basis, in that the members pay for all their expenses and are not entitled to any share in the profits and surplus, if any, is used for maintenance and development of the club, the notional income from house property in respect of the club building is not assessable to tax, on the principle of mutuality which will extend to such deemed income also on the facts of the case. A club which has no commercial activities is not taxable in respect of the charges it makes to its members for providing them temporary accommodation in its premises.[25]

When a club earns interest from fixed deposits, the thread of mutuality is broken and the interest is chargeable to tax. None of the three tests as culled out in Bankipr Club could be satisfied, even if the banks are cor-porate members of the club. It was held that the moneys deposited with the bank are used in its lending business and profits are earned thereon, breaking the chain of mutuality. The "object" of the club is not furthered by the act of placing the surplus funds in a fixed deposit, since no infrastructure or service is provided using this surplus[26].

International understanding

UK, where the doctrine was first established by the courts continues significantly on the common law doctrine of mutuality where limited legislative enactments have not denied but supported the application of the principle. The concept of mutuality was based on an association of persons who had joined together, not to derive profits or gains but to achieve, through their mutual contributions, a purpose or benefit in which all members could participate or were entitled to do so. The term 'mutual organisation or association' has been applied to define a group of individuals, known as members, who have formed a reciprocal relationship with each other to either become their own insurers or for some other common purpose. To date, these entities continue to exist in many sectors of the community and play a significant role. Modern forms of mutual entity cover a wide range of activities, such as recreation, sports, community services and investments.

The USA, New Zealand and Canada have all adopted a regulatory framework. In the UK, the trading profits of mutual entities remain tax-exempt if the profits are applied solely towards the tax-exempt purpose of the entities as stated in section 360(1)(e) of the Taxation Act 1970 (UK). However, certain activities that would normally fall within that exemption are explicitly made taxable, such as fundraising activities (Taxation Act 1970 (UK), section 256).

The approach adopted in the USA and Canada has been to remove the complexity of the mutuality principle by considerably reducing its application through the introduction of threshold requirements that must be satisfied before the principle can apply. For example, a tax exemption is provided to social clubs that meet very strict requirements as to the source of their income. Over a twelve-month period, at least 75% of the club's total gross receipts must be derived from its members or through investment income. In other words, the legislation deems the existence of a profit-making purpose when a significant portion of the club's revenue is derived from the general public.

Australia has inherited large amounts of English common law, including the principle of mutuality. Australian courts have consistently found that the mutuality principle, which evolved from UK legal precedents, applies equally within the context of Australian taxation laws. While Australian income tax legislation has since its inception exempted certain non-profit organisations from being taxable – such as charitable institutions and funds, and public religious and educational institutions – it has made no statutory reference

25 (2000) 243 ITR 89(SC): Chelmsford Club vs. CIT

26 (2013) 350 ITR 509 (SC): Bangalore Club vs. CIT

to the principle of mutuality. Mutual entities did not derive any income within the definition of the term as used in the income tax legislation. In the absence of any explicit statutory provisions providing for the contrary, mutual income is not subject to income tax by virtue of the mutuality principle itself and not because it is 'exempt' from income tax. In Australia, some entities have been excluded from the application of the mutuality principle by specific income tax provisions, including life assurance companies, life insurance companies, specific friendly societies, certain co-operatives, mutual insurance companies and credit unions. sporting clubs whose activities are dominated by gaming activities. However, the mutuality principle continues to apply to all non-profit mutual entities to the extent that it has not been displaced by statutory provisions in the Act.

Summarised Principles of Mutuality

Over the years, the mutuality principle has been the subject of substantial legal litigation. A considerable body of legal precedents has built up in relation to the principle and its application, from which the underlying concepts regarding the application of the mutuality principle can be established. This process of drawing together the principles from the cases from India, England and Australia and others into a consistent and logical set of concepts may be summarised as follows:

(i) The members must share a common purpose. That common purpose or benefit must be the main purpose for which the association is established in the first instance. Subsidiary purposes or benefits are permissible only as long as they are ancillary to the main purpose.

(ii) The common fund gives effect to the common purpose. There must be a common fund created for the common purpose to which all members contribute and participate on a voluntary basis. The contributions to the common fund give effect to the purpose for which the entity was established.

(iii) The members have ownership and control of the common fund at all times. The common fund is not the beneficial property of the mutual entity. As contributors to the common fund, members are the owners of the common fund even though the entity, in effect and as a matter of practicality, has possession of the fund as agent or trustee for the members. The effective control of the fund would generally be established through voting rights granted under the entity's constitution. If the common fund is owned or controlled by anyone other than its contributors the mutuality principle has no application.

(iv) The contributors to the common fund are the only participants in the fund. At a given point of time, there is complete identity between the contributors and the participators. The individuals who are contributing to the common fund must be identical to the individuals who participate or are entitled to participate in any distribution of the mutual surplus fund from the entity, not necessarily all the members of the entity to participate in all the activities equally if they are eligible or entitled to participate on equal terms or to participate equally at all times. The reference to 'identity' is applied within the context of a class of individuals and not to individual persons.

(v) The membership interests in the common fund may consist of different classes. Equal contributions to the common fund are not an essential feature of the mutuality principle. There can be different classes of membership with varying rates of subscriptions and different entitlements to the facilities. Members with full membership are those members who control the common fund and have the same rights, privileges and obligations. Where associated persons have been allocated the same rights (but not the same obligations) as full members, they are not members for the purpose of the mutuality principle.

(vi) The mutual relationship is for the collective benefit of all the members. The mutuality principle applies to entities which are carried on for the benefit of their members as a whole but not for the profit or gain of their members severally or individually. If the object of the entity is the provision of gains or profits to the individual members, the mutuality principle cannot apply. All the contributions to the common fund must be applied by the entity for the collective benefit of all the members in line with the common purpose.

(vii) The membership interests in the common fund cannot be sold or transferred. A membership interest continues to exist only during the term of the membership with the entity. It effectively becomes extinguished on the death of the member or on the expiration of the membership. Therefore, the membership interest in the entity cannot be sold or transferred, whether or not for consideration.

(viii) Surplus funds may be distributed to the members as mutual income on a proportional basis. Any surplus in the common fund, in excess of the members' contributions, which is returned to the members, is not assessable income to the members. A return of surplus contributions does not constitute a distribution of profits accruing to the members. It is, in essence, a repayment of the members' own money or a refund of the unused portion of the members' contributions.

The mutuality principle continues as a common law doctrine and has not been codified as yet anywhere. The design of the legislative insertion require that it is technically sound and complies with the aims of any taxation review process – equity, efficiency and simplicity coupled with needs to consider its implications for small membership-based non-profit organisations.

State countries have restricted the applicability of mutuality vividly. In India one finds codified denial of the principle say under section 2(24)(vii) the profits and gains of any business of insurance carried on by a co-operative society, even if it is a mutual concern, are made taxable in all cases as income and are to be computed in accordance with the rules in the First Schedule; Section 2(24)(viia) taxes the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Section 28(iii)/section 2(24)(v) also taxes income derived by a trade, professional or similar association from specific services performed for its members. Under section 27(iii) a member of a co-operative society to whom a building or part thereof is allotted or leased under a house building scheme of the society is deemed to be the owner of that building or part of that building is assessable as such.

There are as well specific acceptances of the principle in certain areas of co-operative movements as well as 'some incomes of approved professional associations or institutions in the field of law, accountancy, sports etc., u/s. 10(23A)'. Section 44A deals with the case where receipts by a trade, professional or similar association from its members, by way of subscription or otherwise, fall short of the expenditure incurred by the association for the purpose of protecting or advancing the common interests of its members. Certain incomes of co-operative societies are exempt from tax under section 80P. Under section 80Q, prior to its deletion with effect from April 1, 1973, a member of a co-operative society was exempt from tax in respect of any dividends received by him from the society.

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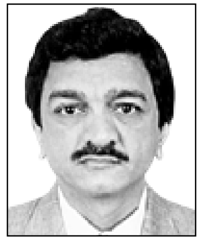

B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Reassessment to verify information received by the AO from VAT Department relating to purchase made by assessee from hawala dealers: Not justified

Pr. CIT vs. Manjit Dineshkumar Shah [[2019] 101 taxmann.com 259 (SC)

1. For the A.Y. 2009-10 the assessee filed return of income which was processed u/s. 143(1) of the I.T. Act, 1961. Subsequently information was conveyed by the DGIT (Inv.), Mumbai to DGIT (Inv.), Ahmedabad along with the Board's confidential letter to take action in respect of cases of non-genuine Bills-information emanating out of VAT Department, Mumbai. Pursuant to the information forwarded by CIT-V, Ahmedabad, the joint CIT, Range-11, Ahmedabad, forwarded the same to the AO who recorded the reasons as under:

> "The information received from the VAT Department, Mumbai relating to bogus purchases of each beneficiary firm from Hawala Biller. On verification of information it is found that the assessee MANJIT DINESH KUMAR SHAH has also made purchases of ₹ 3,21,74,262/- during the F.Y. 2008-09 (A.Y. 2009-10) from Hawala Dealer as information received by this office. It needs deep verification.
>
> "I have therefore firm reason to believe that the income chargeable to tax has escaped assessment for the A.Y. 2009-10 due to the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment. Thus, the case needs to be reopened by issuing notice u/s. 148 of the I.T. Act, 1961."

2. The Tribunal held that the notice was invalid and therefore, the Revenue preferred the appeal to the High Court of Gujarat and contended that the AO had sufficient material to enable him to form a belief that income chargeable to tax has escaped assessment. It was further contended that after verifying the information emerged from the record, the AO was *prima facie* of the opinion that the assessee has shown purchases from Hawala dealer and therefore, the purchases were bogus and the original assessment was completed u/s. 143(1) of the Act.

3. Dismissing the appeal of the Revenue, their Lordships of the Gujarat High Court held as under:

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"7. It is equally well-settled that the notice of reopening can be supported on the basis of reasons recorded by the Assessing Officer. He cannot supplement such reasons. The third principle of law which is equally well-settled and which would apply in the present case is that reopening of the assessment would not be permitted for a fishing or a roving inquiry. This can as well be seen as part of the first requirement of the Assessing Officer having reason to believe that income chargeable to tax has escaped assessment. In other words, notice of reopening which is issued barely for making fishing inquiry, would not satisfy this requirement.

"8. With this background, we may revert to the reasons recorded by the Assessing Officer. Information from the Value Added Tax Department of Mumbai was placed for his consideration. This information contained list of allegedly bogus purchases made by various beneficiaries from Hawala dealers. Assessee was one of them. As per this information, he had made purchases worth ₹ 3.21 crore (rounded off) from such Hawala dealers during the financial year 2010-11. According to the Assessing Officer, this information 'needed deep verification'.

"9. If on the basis of information made available to him and upon applying his mind to such information, the Assessing Officer had formed a belief that income chargeable to tax has escaped assessment, the Court would have readily allowed him to reassess the income. In the present case however, he recorded that the information required deep verification. In plain terms therefore, the notice was being issued for such verification. His later recitation of the mandatory words that he believed that income chargeable to tax has escaped assessment, would not cure this fundamental defect.

"10. Learned counsel for the Revenue however urged us to read the reasons as a whole and come to the conclusion that the Assessing Officer had independently formed a belief on the basis of information available on record that income in case of the assessee had escaped assessment. Accepting such a request would in plain terms require us to ignore an important sentence from the reasons recorded viz., 'it needs deep verification'.

4. Against the aforesaid judgment of the Gujarat High Court, the Special Leave Petition filed by the Revenue is dismissed as their Lordships did not see any reason to interfere in these matters.

Waiver of repayment of unsecured loan in respect of which there was no allowance or deduction claimed by assessee during the previous years amounted to capital receipt not liable to tax under section 41(1)

Commissioner of Income-tax vs. Compaq Electric Ltd. [(2019) 101 taxmann.com 400 (SC)]

1. The assessee-company was a wholly owned subsidiary company of DRL and it was manufacturing and trading in halogen lamps. In view of huge losses suffered by the assessee-company, operations of the company had been funded by way of unsecured loans from DRL from year to year and such loans accumulated to about ₹ 11.64 crore during the years. In view of the mounting losses and doubtful viable operations, the assessee-company proposed, and DRL accepted a request to agree for conversion of the unsecured loan partly into equity share capital and waive the balance as not recoverable. Accordingly, the assessee-company converted unsecured loan into equity to the extent of ₹ 9.00 crore and wrote back the balance amount

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of ₹ 2.64 crores as not payable. The Assessing Officer held that these loans were received during the course of assessee's business with DRL, and that the liability of the assessee was a trading liability and, accordingly, section 41(1) was attracted in respect of amount of unsecured loan written off. On appeal, the Commissioner (Appeals) accepted the case of the assessee by holding that the amount representing waiver constituted capital receipt, and therefore, not liable to tax. The Tribunal upheld the order passed by the Commissioner (Appeals).

2. Dismissing the appeal of the Revenue, their Lordships of the Karnataka High Court held that for the application of this Act, the condition precedent is that there should be an allowance or deduction in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41. The whole object is to avoid double benefit to the assessee. In the instant case, the amount claimed as capital receipt is in respect to which there was no allowance or deduction claimed by the assessee for the previous year. Therefore, when his creditor has waived the repayment of the said amount, it amounts to a capital receipt and not a revenue receipt. As the assessee did not have the benefit of any allowance or deduction in respect of the said amount, Section 41 is not attracted.

3. Against the aforesaid order of the Karnataka High Court, the Special Leave Petition filed by the Revenue was dismissed by the Supreme Court holding that the matter is covered against the Petitioner as per the judgment of the Supreme Court in the case of *CIT vs. Mahindra & Mahindra Ltd. (404 ITR 1, SC).*

SLP dismissed against High Court ruling that where in return filed in response to reassessment notice, assessee declared undisclosed income found during search and Assessing Officer passed assessment order accepting same, another reassessment notice issued beyond a period of four years was unjustified in absence of any new information or material.

Deputy Commissioner of Income-tax, Central Circle-2 vs. Jalil Abdulbhai Shaikh [(2019) 101 taxmann.com 258 (SC)

1. During the survey at the premises of the assessee, a diary showing receipt of unaccounted cash and professional income by assessee was found and impounded. The assessee in his statement u/s. 131 accepted that he had received unaccounted cash and professional income. Pursuant thereto, a notice u/s. 148 was issued to which the assessee had filed his return. The AO accepted the return and passed the order u/s. 143(3) r.w.s. 147 of the Act.

2. After four years from the end of assessment year, another notice u/s. 148 was issued on the ground that in so far as entries in the diary were concerned, figures of unaccounted cash amounts were recorded after dropping 10. Therefore, the figures of professional receipts should be considered by adding 10.

3. Allowing the petition and quashing the second notice u/s. 148 of the Act, their Lordships of the Gujarat High Court held as under:

> "8. We may recall, during the survey operations, the assessee was confronted with such entry in the diary and the assessee admitted that the said figure of ₹ 5,96,914/- represented his unaccounted cash and professional receipts, which he had not offered to tax. While therefore filing a return in response to the notice under section 148 of the Act, the assessee

included such income in the declared income. The Assessing Officer accepted such return and, as noted earlier, barring minor adjustment of claim of expenditure, confirmed the assessee's declaration of income. To reopen such assessment, the impugned notice came to be issued which clearly is beyond the period of four years from the end of relevant assessment year. The reasons proceed concededly only on the material available on record. Such relevant material included the notings in the assessee's diary which recorded a figure of ₹ 5,96,914/- as outstanding fees to be collected and other entries referring to certain outstanding payments. The Assessing Officer now contends that in so far as other entries are concerned, there is material to believe that the figures in the diary were recorded after dropping one zero. The Assessing Officer therefore now contends that even the said figure of ₹ 5,96,914/- should be considered as the assessee's undisclosed income by adding one zero.

"9. We are not called upon to decide the validity of Assessing Officer's contention. The fact remains that whatever legal conclusions on the basis of the factual analysis the Assessing Officer desirous to arrive at, is based on the material already on record all throughout during previously reopened assessment proceedings. In absence of any new information or material which do not form part of the original assessment proceedings, it would not be open for the Assessing Officer to frame fresh assessment, that too, in a case where the notice of reopening has been issued beyond a period of four years. Even otherwise, permitting the Assessing Officer to re-examine the entire issue once again, looking at materials on record from a different angle would destroy the very concept of finality of an assessment order which can be permitted only on legally recognized grounds."

4. The Special Leave Petition filed by the Deputy CIT to the Supreme Court was dismissed on the ground that their Lordships did not see any reason to entertain the Special Leave Petition under Article 136 of the Constitution.

Supreme Court requests UOI to make suitable amendments in section 80DD so that maturity sum in Jeevan Aadhar Policy floated by LIC in terms of section 80DD is disbursed for benefit of disabled persons even before death of assured parents/guardian.

Ravi Agrawal vs. Union of India [(2019) 101 taxmann.com 70 (SC)]

1. The petitioner, a differently abled person, filed writ petition under Article 32 of the Constitution of India as a Public Interest Litigation in the interest of handicapped children whose parents had taken Jeevan Aadhar Policy from the Life Insurance Corporation of India (LIC) for the livelihood of their children.

2. Section 80DD provides for payment of annuity or lump sum amount for the benefit of a dependent, being a person with disability, in the event of the death of the individual or the member of the Hindu Undivided Family (HUF) in whose name subscription to the scheme stipulated in the said provision has been made.

3. As per condition mentioned in clause (a) of section 80DD(2) disabled dependent would get annuity or lump sum payment in the event of death of the individual or the death of the member of the HUF, in whose name subscription to the scheme had been made. In order to give effect to the aforesaid special provision meant for the benefit of persons

with disability, LIC floated insurance policy named 'Jeevan Aadhar' for the benefit of the handicapped dependents. Accordingly, those assessees who get the Jeevan Aadhar policy for the benefit of handicapped dependants and pay or deposit the amount under the said policy become entitled to the deduction mentioned in section 80DD.

4. The grievance of the petitioner pertained to Circular No. Co/CRM/PS/622/23 dated 24-1-2008 which was issued by the Income-tax Department. As per that Circular, no benefit can be paid to the dependent till the proposer/life assured survives.

5. In the policy there was clause that even when the entire subscription was paid under the policy meant for handicapped persons, the policy did not have maturity claim. The amount was payable to the dependent only on the demise of the proposer/life assured.

6. The petitioner even approached the Court of the Chief Commissioner for Persons with Disabilities raising the aforesaid grievance. The Chief Commissioner passed the order advising the CBDT to once again examine the matter in consultation with the Department of Empowerment of Persons with Disabilities, Ministry of Social Justice and Empowerment, as well as National Trust.

7. In essence, the grievance of the petitioner was that benefit of Jeevan Aadhar policy should not be deferred till the death of the assessee/life assured and it should be allowed to be utilised for the benefit of the disabled person even during the lifetime of the assessee.

8. Their Lordships of the Supreme Court held as under:

> "15. At the outset, it may be observed that Section 80DD of the Act is a provision made by the Parliament under the Act in order to give incentive to the persons whose dependents are persons with disability. Incentive is to give such persons concessions in income tax by allowing deductions of the amount specified in Section 80DD of the Act in case such parents/guardians of dependents with disability take insurance policies of the nature specified in this provision. Purpose is to encourage these parents/guardians to make regular payments for the benefit of dependents with disability. In that sense, the Legislature, in its wisdom thought it appropriate to allow deductions in respect of such contribution made by the parent/guardian in the form of premium paid in respect of such insurance policies. Of course, this deduction is admissible only when conditions stipulated therein are satisfied.
>
> "16. In so far as insurance policy is concerned, it incorporates a condition (which is impugned in the present writ petition) to the effect that the amount shall not be given to the handicapped persons during the lifetime of the parent/guardian/life assured. This is in conformity with Section 80DD(2)(b) of the Act.
>
> "17. To some extent, the grievance of the petitioner may be justified on this behalf in the plea that when there is a need to get these funds even for the benefit of handicapped persons, that will not be given to such a person only because of the reason that the assured who is a parent/guardian is still alive. This would happen even when the entire premium towards the said policy has been paid. The policy does not have maturity claim. Thus, after making the entire premium for number of years, i.e., during the duration of the policy, the amount would still remain with the LIC. That may be so. However, the purpose behind such a policy is altogether different. As noted from the provisions of Section 80DD as well as

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from the explanatory memorandum of the Finance Bill, 1998, by which this provision was added, the purpose is to secure the future of the persons suffering from disability, namely, after the death of the parent/guardian. The presumption is that during his/her lifetime, the parent/guardian would take care of his/her handicapped child.

"18. Further, such a benefit of deduction from income for the purposes of tax is admissible subject to the conditions mentioned in Section 80DD of the Act. The Legislature has provided the condition that amount/annuity under the policy is to be released only after the death of the person assured. This is the legislative mandate. There is no challenge to this provision. The prayer is that Section 80DD of the Act be suitably amended. This Court cannot give a direction to Parliament to amend or make a statutory provision in a specified manner. The Court can only determine, in exercise of its power of judicial review, as to whether such a provision passes the muster of the Constitutional Scheme. Though, there is no specific prayer in this behalf, but in the body of writ petition, argument of discrimination is raised. Here, we find that the respondents have been able to successfully demonstrate that the main provision is based on reasonable classification, which as a valid rational behind it and there is a specific objective sought to be achieved thereby.

"22. The petitioner may be justified in pointing out that there could be harsh cases where handicapped persons may need the payment on annuity or lumpsum basis even during the lifetime of their parents/guardians. For example, where guardian has become very old but is still alive, though he is not able to earn any longer or he may be a person who was in service and has retired from the said service and is not having any source of income. In such cases, it may be difficult for such a parent/guardian to take care of the medical needs of his/her disabled child. Even when he/she has paid full premium, the handicapped person is not able to receive any annuity only because the parent/guardian of such handicapped person is still alive. There may be many other such situations. However, it is for the Legislature to take care of these aspects and to provide suitable provision by making necessary amendments in Section 80DD of the Act. In fact, the Chief Commissioner for Persons with Disabilities has also felt that like other policy holders, Jeevan Aadhar policy should also be allowed to mature after 55 years of age of the proposer and the annuity amount should be disbursed through the LLCs or National Trust.

"23. In the aforesaid circumstances, we dispose of this writ petition by urging upon respondent No. 1 to have a relook into this provision by taking into consideration all the aspects, including those highlighted by the Court in this judgment, and explore the possibility of making suitable amendments."

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Work on ! Hold on ! Be brave ! Dare anything and everything !

— *Swami Vivekananda*

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

DIRECT TAXES
High Court

1. Bar against direct demand on assessee – Section 205 of Income-tax Act, 1961 – No recovery from the assessee for default committed by the deductor to deposit the TDS amount with the Government treasury

Pushkar Prabhat Chandra Jain vs. Union of India & Ors. [W.P. No. 90 of 2019 order dated 30-1-2019, Bombay High Court]

The assessee before the Hon'ble Bombay High Court was an individual. During the assessment year 2016-17, the assessee had sold an immovable property for total consideration of ₹ 9 crore. The purchasers of the said property had made a net payment of ₹ 8 crore 91 lakhs to the assessee after deducting tax at source at 1% of the payment in terms of section 194-IA of the Act. The assessee filed his return of income for the assessment year 2016-17 declaring total income of ₹ 2,28,62,110/-. In the return the assessee had claimed a total of TDS of ₹ 10,71,187/-. The Central Processing System of the Income Tax Department (CPC for short) noticed that only an amount of ₹ 1,71,187/- was deposited with the Government revenue and thus gave credit of TDS to the assessee only to the extent of ₹ 1,71,187/-. This mismatch was on account of the fact that purchasers of immovable property, had not deposited the sum of ₹ 9 lakh deducted from the assessee while making payment of the sale consideration. The return of the assessee was taken up for scrutiny. During the pendency of such scrutiny proceedings the TRO issued the notice dated 5th February, 2018, which was addressed to the Branch Manager of State Bank of India attaching the bank account of the assessee in the said bank for recovery of an amount of ₹ 10,36,000/-. On 26th March, 2018, the TRO withdrew a sum of ₹ 2,46,900/- from the assessee's said bank account. A further sum of ₹ 1,20,700/- was withdrawn from the same account on 6th April, 2018. Thus, a total of ₹ 3,67,600/- was withdrawn by the department from assessee's bank account for recovery of the said unpaid demand. The assessee being aggrieved filed a Writ Petition before the Hon'ble Bombay High Court. The Court observed that section 205 of the Act carries the caption "Bar against direct demand on assessee". The section provides that where tax is deducted at the source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. The Court placed reliance on the case of *Yashpal Sahni vs. Rekha Hajarnavis and ors.(2007) 293 ITR 539 (Bom.)* and held that it is always open for the department and in fact the Act contains sufficient provisions to make coercive recovery of such unpaid tax from the payer whose primary responsibility is to deposit the same with the Government revenue scrupulously and promptly. If the payer after deducting the tax fails to deposit it in the Government revenue, measures can always be initiated against such payers. Under the circumstances, the High Court quashed the recovery notices and asked the department to refund sum of ₹ 3,67,600/- within four weeks, beyond which 8% p.a. would be payable to the assessee. The Court also took note of the fact that for long after issuing notice under section 266(3) of the Act, the assessee had not brought this fact to the notice of the department which led the department to make recoveries from the bank account of the assessee. Hence the assessee would not be entitled to claim interest on the amount to be refunded.

2. Refund – section 244A of the Income-tax Act, 1961 – assessee following project completion method – TDS deducted on the payments made during the completion of project – project completed in subsequent assessment year – Due to loss refund was to be granted - interest on refund allowable from the assessment year in which the TDS was deducted and not when the return is filed

Pr. CIT vs. Kumagai Skanska HCC ITOCHU Group [ITXA No.1230 of 2016, order dated 29-1-2019, Bombay High Court]

The assessee, an Association of Persons was engaged in the business of Civil Construction. The assessee followed the project completion method of accounting to offer its income to tax. For the assessment Years 2003-04, 2004-05 and 2005-06, the Assessee had received certain payments as a contractor, on which the payer had deducted at tax source. In the return of income filed by the assessee for Assessment Year 2005-06, it had declared loss of around ₹ 81.3 crore. The Assessee had claimed the income relatable to the payments received during the said year as well as during earlier two assessment years. The assessment order passed by the AO, gave rise to refund. However, the AO refused to grant interest under section 244A of the Act on the ground that, the income in relation to the payments on which tax was deducted at source, was returned by the assessee in the assessment year 200506. Therefore, interest cannot be paid on the refund for any period prior to the said assessment year. The matter travelled up to Appellate Tribunal. The Appellate Tribunal relying on the decision of Hon'ble Supreme Court in the case of *UOI vs. Tata Chemicals Ltd., 363 ITR 658 (SC)* allowed the claim of the assessee. The department being aggrieved by the order of the Tribunal filed an appeal before the Hon'ble Bombay High Court. The Court observed that sub-section 1 of section 244A of the Act provides for interest on refund in three separate clauses, covering different situations. Clause (a) pertains to cases where the refund is out of any tax collected at source under section 206C of the Act or paid by way of advance tax or treated as paid under section 199 of the Act. Clause (aa) refers to the refund arising out of any tax paid under section 140A of the Act. Clause

(b) essentially provides that in case the refund becomes due in any other case i.e., cases not covered under clause (a) or (aa), such interest shall be calculated at the rate of ½% for every month or part of the month comprised in the period from the date of payment of the tax or penalty to the date on which the refund is granted. This clause (b) contains an explanation which provides that for the purpose of said clause, the date of payment of tax or penalty would mean the date on and from which the amount of tax or penalty specified in notice of demand issued under section 156 is paid in excess of such demand. If the case of a person were to fall under clause (b), the question of applicability of the explanation would certainly arise. It can be seen that clause (a) covers situation where the refund is out of any tax collected at source or paid by way of advance tax or treated as paid under Section 199 of the Act. This reference to treat tax as paid under Section 199 of the Act, would clearly cover the tax deducted at source. The Court observed that the assessee suffered deduction of tax at source at the time of payments. In that view of the matter, the case of the assessee would clearly be covered under clause (a) to sub-section (1) of Section 244 of the Act. In such a situation, the clause clearly provide that, interest shall be calculated at the rate of ½% for every month or part thereof, comprising a period from the 1st day of April of the Assessment Year to the date on which the refund is granted, provided the return is filed before the due date, specified in sub-section 1 of Section 139 of the Act. Here, the reference "from the 1st day of April of the Assessment Year" which is the starting point for computing the interest payable, must be to the Assessment Year, in which the tax was deducted at source. Any other view would be holding untenable since the Revenue which has received the tax deducted at source from the payments to be made to the assessee and appropriate the same, would refund the same but the interest would be accounted much later when the return giving rise to the refund, is filed. The Court thus dismissed the departmental appeal.

3. Stay of demand – CBDT circular dt 29-2-2016 and dt. 31-7-2017 – AO cannot impose precondition 20% without applying his mind to the application made by the assessee

Turner General Entertainment Networks India Pvt. Ltd. vs. ITO – [W.P.(C) 682/2019, Hon'ble Delhi High Court]

In this case the assessee-petitioner's grievance was that its request for stay of demand [made for Assessment Year 2011-12, regarding Financial Year 2010-11], has not been considered on merits at all and that the concerned Assessing Officer (AO) has required the deposit of 20% of the demand as a pre-condition, for consideration of the application for exemption/stay of demand. The assessee approached the Hon'ble High Court by way of a Writ Petition challenging such an order of the AO. It was held by the Hon'ble High Court that the AO had to necessarily apply his/her mind to the application for stay of demand and pass appropriate orders having regard to the extant directions and circulars including the memorandum of 29-2-2016. This in turn meant that AO could not have imposed a precondition of first depositing 20% of the demand before dealing with the stay application. Consequently, the impugned order was set aside and the AO was directed to reconsider the application for stay of demand made by the assessee and pass necessary and appropriate orders, and exercise his discretion having regard to the facts and circumstances of the case, within three weeks time.

4. Transfer pricing – Advance to AE without interest – Advances were given to acquire rights from third party – AE used as conduit – Back to back agreements and payments – Transfer pricing provisions not applicable

Pr. CIT vs. KSS Ltd. – (2019) 101 taxmann.com 357 (Bombay)

The assessee was engaged in the business of production and distribution of films. The departmental appeal related to AY 2009-10. The assessee desired to acquire rights for distribution of three Hollywood films in India. For such purpose, the assessee contacted M/s. Citi Gate Trade FZE ("Citi Gate" for short). According to the assessee, Citi Gate would not deal with the assessee directly and required a foreign based entity. In order to formalise this arrangement of acquisition and distribution rights of the films, the assessee, therefore, used a UAE based company, its associated enterprise, as a conduit. The assessee first entered into an agreement with the said AE which envisaged the AE acquiring distribution rights for the assessee from Citi Gate. On the very next day, the AE entered into an agreement with Citi Gate. To operationalise said arrangement, the assessee advanced certain amounts to the AE. The AE, in turn, immediately paid up such amounts to Citi Gate. However, the arrangement did not materialise. Citi Gate, thereupon, refunded the advance to the assessee through its AE. In the process, however, some time was consumed and the repayment was made over a period of time. The Revenue however, contended that by making interest free advances to the AE, the assessee has transferred its profit and therefore, the transfer price regime would apply. In order to justify invocation of transfer pricing regime the Revenue further contended that the said interest free advances were made out of the borrowed funds of the assessee on which it was paying considerable interest. The Hon'ble High Court after considering the facts as found by the Tribunal held that having regard to the nature of entire arrangement and the different transactions, the explanation to section 92B would not cover the present situation. The Court observed that the present case was a simple one where the money was routed through the AE by the assessee for the purpose of acquisition of distributorship. This was not a case of either financing or landing or advancing of any moneys. The back-to-back agreements, the contents thereof and most significantly, the fact that neither at the point of payment nor at the point of refund of money, the AE retained the same for any significant period of time, which in Court's opinion, were very crucial. This transaction did not result into diversion of income of the assessee to its AE. The Tribunal, therefore, committed no error. The Court held that no question of law arose in this respect. The Court held that once it is concluded that the transaction did not give rise to the international transaction, the rest of the issues would become academic.

5. Validity of notice u/s. 143(2) in case of defective return – action of removing defects relate back to the date of filing original return – subsequent notice u/s. 143(2) invalid

Atul Projects India Pvt. Ltd. vs. UOI, Writ Petition no. 3501 of 2018, order dt. 24-1-2019, Bombay High Court.

The assessee was a company. For AY 2016-17, assessee filed return of income on 17-10-2016 declaring total income of around ₹ 22.15 crore. On 28th August, 2017 the Assessing Officer issued a notice under Section 139(9) of the Act requesting the assessee to rectify certain defects in filing of the return. The notice granted statutory period of 15 days to take such steps. On 12th September, 2017 i.e. within the time permitted assessee removed the defects. The defects were technical in nature and did not result into any change in petitioner's total income. Yet another notice was issued by the department on 19 September, 2017 under Section 139(9) of the Act conveying that the return filed on 12th September, 2017 in response the directions for removing the defects was also considered to be defective. On 29th September, 2017, assessee electronically represented to the department that there was no defect in such return. There was no response from the Department to this communication of the assessee, nevertheless it appeared that the department proceeded on the basis that such representation was proper as no further notice to remove any defects was communicated. On 10th February, 2018, the Assessing Officer processed return under Section 143(1) of the Act, which was duly communicated to the Assessee. On 10 August, 2018, the Assessing Officer issued a notice under Section 143(2) of the Act, conveying that the return in question is taken in scrutiny. The Assessee challenged such notice on the ground that the same was barred by the limitation. It was submitted before the High Court that such notice of scrutiny had to be issued within 6 months from the end of the financial year during which the original return was filed. According to the assessee, therefore, the last date for issuing such notice was 30 September, 2017. The department however contended that the relevant date of filing of the return would be the date on which the assessee in response to the defects pointed out by the department, filed revised return curing the defects in the original return. Thus notice issued by the Assessing Officer on 10th August, 2018 was valid. Under the circumstances, the sole question before the High Court was which of the two of the above noted dates can be stated to the date on which the assessee filed its return of income. The Court noted in case of filing of a defective return by the assessee (which may not be confused with filing of the invalid return) upon such defects being removed within the time permitted, such action of removal of defect would relate back to the filing of the original return. Under the circumstances, the date of the filing of the return would be the date on which it was initially presented and not the date on which the defects were removed. Thus the Court held that notice dated 15th November, 2018 was invalid and was set aside.

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

DIRECT TAXES
Tribunal

Unreported Decisions

1. Section 148 – A notice issued u/s. 148 of the Act is bad in law and without jurisdiction if the same is issued in absence of any tangible material even if the return of income was processed u/s. 143(1) of the Act

DCIT, CC-4(3), Mumbai vs. M/s. Kargwal Products Pvt. Ltd.(ITA 1462/Mum/2017) [Assessment Year: 2009-10], order dated 11-7-2018

Facts

The Respondent assessee is a private limited company and the assessment year under consideration is 2009-10. For the present assessment year, the assessee filed its return of income declaring the loss at ₹ 33,230/-. The said return was processed u/s. 143(1) of the Act. Subsequently the assessment was reopened and the notice u/s. 148 was issued to the assessee. Pursuant to the said notice,the assessee requested the learned AO to treat the earlier return of income as return filed u/s. 148 of Act. Further the learned AO was asked to furnish copy of reasons recorded by him to the assessee. From the reasons provided, the assessee noticed that the said reassessment proceedings were initiated to verify the huge share premium of ₹ 1,33,77,000/- received by the assessee for the year under consideration on the observation that no scrutiny assessment took place earlier and the said transaction was never examined. The assessee objected to the reasons by filing its objections at the office of the learned AO which were disposed off by the learned AO Thereafter, the learned AO made various enquiries regarding the said premium of ₹ 1,33,77,000/- and the said amount was added u/s. 68 of Act. Being aggrieved by the same, the assessee preferred an appeal before the learned CIT(A). The said appeal was allowed by the learned CIT(A) on the jurisdictional aspect against which the appeal was preferred by the Revenue before Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under.

Held:

Hon'ble ITAT observed that the learned A. O. in the facts under consideration assumed the jurisdiction without possessing any tangible material and there cannot be any reason to believe on the part of the learned A. O. that income chargeable to tax has escaped assessment for the year under consideration. While coming to the above-mentioned

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observation, Hon'ble ITAT relied upon various judgments of Hon'ble High Courts including the judgements of jurisdictional High Court.Finally, the appeal filed by the Revenue was dismissed and the issue was decided in favour of the Respondent assessee.

2. Section 50C – Provisions of section 50C of the Act have no applicability in the case where there is no transfer of land or building or both

Maitri Morarji vs. ITO [ITA 3864/Mum/2016] (Assessment Year: 2010-11) dated 2-12-2018

Facts

The assessee is an individual and the assessment year under consideration is 2010-11. For the present year, the assessee filed her return of income declaring the Long-Term Capital Gains of ₹ 44,95,340/- on sale of residuary rights in inherited property. The said property situated at village Wadhavali, Kurla was transferred to Tata Power Co. Ltd. by Mr. Pratapsinh Morarji *vide* agreement dated 10th March 1971 for total consideration of ₹ 34,937/-. As per the said agreement, 10% of the consideration was payable as earnest money, 50% was payable on handing over the formal possession and the balance 40% was payable on completion of sale. It was stipulated in the said agreement that the sale was to be completed within four years since time is an essence of contract. Pursuant to the same, the possession was handed over to Tata Power Co. Ltd. However, the sale could not be consummated since the said property continued to be occupied by hutments/ trespassers. Thereafter, on demise of Mr. Pratapsinh Morarji, the residuary rights in the said property were bestowed with the five legal heirs including assessee. The assessee's share in the said property was 8.33%. The assessee along with other legal heirs entered in to the conveyance deed dated 31-12-2009 pertaining to the Assessment Year under consideration through which the residuary rights of the legal heirs were transferred to the Tata Power Co. Ltd., for the consideration of ₹ 6,40,00,000/-. Pursuant to the said conveyance deed, Tata Power Co. Ltd., started enjoining unencumbered property. The assessee in the return of income offered Long Term Capital Gains of ₹ 44,95,340/- by taking 8.33% of total consideration and adopting cost of acquisition as on 1-4-1981. The learned AO held that since the consideration received by the assessee was less than stamp duty valuation, the provisions of section 50C of the Act would have applicability in the present case. Further, the learned AO referred the case to the DVO and adopted the value determined by him. The assessment order was passed by determining total income at ₹ 69,26,260/- and making the addition of ₹ 23,30,925/- under the head Long Term Capital Gains after invoking the provisions of section 50C of the Act. On appeal, the learned CIT(A) confirmed the action of the learned AO. The assessee being aggrieved by the said order preferred an appeal before Hon'ble ITAT. Before the assessee raised an additional ground before Hon'ble ITAT stating that the provisions of section 50C have no applicability in the present case since there is no transfer of land or building or both in the year under consideration. After hearing both the sides, Hon'ble ITAT observed as under:

Held

The conveyance deed executed between the legal heirs and *Tata Power Co. Ltd.*, was inextricably linked with the sale agreement dated 10-3-1971. The purchaser had acquired certain rights in the said property in the year 1971 when the possession was also handed over to the *Tata Power Co. Ltd.* The seller had already transferred certain rights out of bundle of rights in the said property in favour of the purchaser in the year 1971 by entering into the sale agreement as well as by handing over the possession of the property to the purchaser. Therefore, the assessee had inherited only the remaining rights in the aforesaid property. The assessee was not an absolute owner of the property. The conveyance deed was one of the rights attached to the property which had been transferred by the assessee in favour of the purchaser for certain consideration. Therefore, the same could not be considered as "sale" of the said property as concluded by authorities below. The assessee merely received compensation against the sale of residuary rights in the said property. This being the case, the provisions of Section 50C of Act have no applicability at the threshold to the facts of the case. Further, with respect to cost of acquisition, Hon'ble ITAT held that the cost of acquisition of the said right in the property is to be taken as Nil/- since the property under question was acquired by the owner way back in 1966 and the same was sold in 1971 and it was that time when the benefit of cost of acquisition was available to the seller. Further, it was held that LTCG earned by the assessee during the year was ₹ 52,56,200/- being net consideration received by her *vide* deed of conveyance. The benefit of cost of acquisition could not be allowed to the assessee. On the abovementioned observations, the Appeal was allowed partly.

3. Section 54 – Claim u/s. 54 shall be allowed when the construction of the flat is completed within 3 years from the date of the sale of old property and the date of commencement of construction is irrelevant

Amritlal B. Sahu vs. ITO 18(1)(2) [ITA 265/Mum/2015](Assessment Year: 2009-10), order dated 31-8-2018

Facts

The assessee is an individual. In the return of income, the assessee declared Long Term Capital Gain and also claimed a deduction u/s. 54 of the Act. During the year under consideration, the assessee sold the flat in the building called "Shital Chaya" for which he entered into the agreement of sale dated 23-10-2009. Now coming to the property which was claimed as constructed for a deduction u/s. 54, the brief facts were like this. The assessee along with other two brothers held tenancy rights in the building called "Matru Chaya" since 1995-96 which was owned by their father. In the year 1998, the assessee's father approached the assessee and his two brothers to give consent for redevelopment of the said building. The assessee and other brothers agreed for the same with a condition that on surrendering their tenancy rights, they would get flats in a redeveloped building on ownership basis. However,one of the tenants refused to vacate the property for which the suit was filed against the said tenant and the permission for construction was obtained from the court. The father of the assessee being in need of money took the advance from his sons to complete the construction work. On 25th March, 2003, the assessee and other two brothers entered into an agreement for purchase of additional areas over and above the area which they were entitled to have against their tenancy rights. Accordingly, the assessee and his other two brothers purchased the flat no. 401, 501, 601 in the said "Matru Chaya" building respectively. Thereafter, the father of the assessee passed away and the assessee along with his two brothers stepped into the shoes of father and discharged all his liabilities. The construction of the said building was completed and the possession of flats was handed over to the respective buyers in the year under consideration. Thus, the assessee took the date of purchase of a new flat as 23-3-2009 on the contention that the possession as well as final payment took place in the year under consideration and claimed a deduction u/s. 54 of the Act. The learned AO denied the claim of the assessee on the observation that the date of purchase is 25-3-2003 since the agreement was entered into on the said date. Being aggrieved, the matter was carried out before the learned CIT(A) without any success. Thereafter, an appeal was preferred before Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

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Held

Hon'ble ITAT observed that authorities below only considered one aspect of Sec. 54 of the Act (i.e., purchase of a residential house) but it did not specify whether the same amounted to "construction of a residential house". Hon'ble ITAT placed reliance on the decision of Hon'ble Bombay High Court in the case of *CIT vs. Mrs. Hilla J. B. Wadia (1995)(216 ITR 376)* and came to the conclusion that the case of the assessee should be considered as "Construction" and not "Purchase". Thereafter, Hon'ble ITAT analysed the time period mentioned u/s. 54 of the Act and observed that in the instant case, the assessee had entered into an agreement on 25-3-2003. The date of transfer of old flat is 7-7-2008. There is no dispute that the final payments for new flat was given after 7-7-2008 and the possession of the same was taken by the assessee in the month of March, 2009, i.e., after the date of transfer of the old flat. Thus, Hon'ble ITAT concluded that the assessee was entitled for a deduction u/s. 54 of the Act. While coming to the said conclusion, Hon'ble ITAT placed reliance in the case of *"CIT vs. J. R. Subramanya Bhatt (1987)(165 ITR 571) (Kar.)* wherein it is held that the date of commencement of construction is irrelevant for the purposes of section 54 of the Act. Accordingly, Hon'ble ITAT set aside the order of the learned CIT(A) and directed the learned AO to allow a claim of deduction u/s. 54 of the Act. The case was decided in favour of the assessee and against the Revenue.

Reported Decisions

4. Section 69A – When the additions are based on loose papers found at the premises of the assessee, only profits embedded in unaccounted receipts are liable to tax

DCIT vs. Mehul T. Desai (ITA 350/AHD/2017) [Assessment Year: 2014-15](101 taxmann.com 234 (Surat-Trib.), order dated 13-12-2018

Facts

The assessee is an individual and the assessment year under consideration is 2014-15. A survey u/s. 133A of the Act was carried out at the premises of the assessee who was a proprietor of a clinical laboratory. For the present year, the assessee filed a return of income on 23-10-2014 declaring total income at ₹ 66,97,770/-. However during the assessment proceedings, the learned AO observed that such income is not correct since the loose papers pertaining to a part of year (i.e., 1-9-2013 to 3-3-2014) found in survey showed the unaccounted receipts much higher than the income shown in the return of income. As per the learned AO's contention the assessee did not bring all the receipts on record. On the said observation, the learned AO rejected the assessee's books of account and on basis of the said documents pertaining to a period of six months, worked out unaccounted receipts for whole year and added the said amount to the assessee's income. Being aggrieved by the same, the assessee preferred an appeal before the learned CIT(A) and contented that only profits embedded in such receipts would be chargeable to tax. The said contention was accepted by the learned CIT(A) and the appeal of the assessee was allowed. Being aggrieved by the same, the Revenue preferred an appeal before Hon'ble ITAT. After listening to both the sides, Hon'ble ITAT held as under:

Held

Hon'ble ITAT first analysed Section 145 of the Act and observed that Section 145 would reveal that it provides the mechanism how to compute the income of the assessee. Further it noted that the action of rejection of books of account is not disputed by the assessee as well as the Revenue. It further held that once the learned AO has worked out unaccounted receipts for the whole year on the basis of evidence found for the period of six months, then such working is based on an estimate and assumption, and in the same manner corresponding expenditure ought to be assumed and estimated, because no entity could earn gross receipts. Hon'ble ITAT went through the order of the learned CIT(A) in which the learned CIT(A) categorically held that the Courts have time and again held that what is to be added is the profit embedded in the suppressed receipts, by way of the suppression and not the entire receipts. It further observed that the learned CIT(A) determined the profit based on the preceding five assessment years which is justified. Finally, Hon'ble ITAT came to the conclusion that the order of the learned CIT(A) requires no interference. The appeal of the Revenue was dismissed and the issue was decided in favour of the assessee.

5. Section 23(1)(c) – Due to fall in prices of the property, the assessee could not let out property in the same year and the property remained vacant in spite of efforts, the assessee is entitled for vacancy allowance u/s. 23(1)(c)of the Act

Ms. Priyananki Singh Sood vs. ACIT (ITA 6698/DEL/2015) [Assessment Year: 2012-13] (101 taxmann.com 45 (Delhi-Trib.)), order dated 13-12-2018

Facts

The assessee is an individual and the assessment year under consideration is 2012-13. During the course of the assessment proceedings, The learned AO observed that, the assessee had not offered any rental income under the head income from House Property and subsequently, the learned AO made an addition u/s. 23(1)(a) of the Act considering the annual value of property to be the sum for which the property might reasonably be expected to let out year-to-year. Being aggrieved by the same, the assessee preferred an appeal before the learned CIT(A). During the course of the Appellate proceedings, it was submitted that the property under question was a commercial flat which was purchased back 1980 and was let out. The property was continuously let out till assessment year 2001-02 and thereafter from the assessment year 2002-03, a suitable tenant could not be found and the flat remained vacant. Thus, the property had to be considered as per provisions of Sec 23(1)(c) of the Act. However the said submissions did not impress the learned CIT(A) who confirmed the stand of the learned AO. Thereafter, the assessee preferred an appeal before Hon'ble ITAT. After listening to both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT referred to Sec 23(1)(c) of the Act and came to the conclusion that if a property is held with an intention to let out in the relevant year coupled with efforts made for letting it out, it could be said that such a property is a let out property and the same would fall within the purview of clause (c) of section 23(1). Hon'ble ITAT observed that assessee always had the intention of letting out the property post assessment year 2002-03, however, due to fall in property prices, the same could not be let out year after year because of which disputed property remained vacant. It further noted that one more relevant factor is that, the learned AO in any of preceding assessment year, post assessment year 2002-03, has never disputed that the property was not vacant. In fact in the assessment order passed for year under consideration, the learned AO admitted to the fact that the property in question was let out only till assessment year 2002-03 and thereafter it was vacant, even during year under consideration. In the light of the same, Hon'ble ITAT came to the conclusion that the intention of the assessee was very clear to let out the said property but the same could not be let out despite making several efforts. Finally, Hon'ble ITAT allowed the vacancy allowance to the assessee and decided the issue in favour of the assessee.

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INTERNATIONAL TAXATION Case Law Update

A. SUPREME COURT

1. Issue of TP adjustment on account of consultancy charges restored back to the High Court, noting that the High Court had failed to independently evaluate the merits of Revenue's appeals

CIT vs. Reliance Industries – [TS-21-SC-2019-TP] – Civil Appeal No. 37/2019

Facts

(i) The TPO had made an adjustment / addition on account of international transactions for consultancy charges with AE based in Europe.

(ii) The CIT(A) deleted the said adjustment and the Tribunal also upheld the said deletion following the order for prior assessment year.

(iii) The High Court upheld the Tribunal's order noting that the Revenue had accepted that the facts and circumstances for the prior assessment year and the assessment year under consideration were identical.

(iv) Aggrieved by the above, the Revenue filed the Special Leave Petition before the Supreme Court on the following question:

"Whether the High Court was correct in sustaining the deletion of Transfer Pricing adjustment made to consultancy charges especially when the TPO had adopted same mark-up in relation to its European associate which was similar to what the assessee has adopted for in relation to its USA Associate?"

Held

(i) The Apex Court held that in order to facilitate a fresh exercise being conducted in relation to the aforesaid question, the appeal was allowed and restored the same to the file of the High Court, noting that the High Court had failed to independently evaluate the merits of Revenue's appeal.

B. HIGH COURT

2. Liaison office of GE Group in India which carried out core marketing and sales activities and had prominent involvement in the contract finalisation process, showed that the overseas entities of GE Group carried on business

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in India through such fixed place of business and thus had fixed place PE in India. Further, the expat employees working at such fixed place constituted Dependent Agent PE in India for all the overseas entities of the GE Group

GE Energy Parts Inc. vs. CIT (Intl. Tax) [2019] 101 taxmann.com 142 (Delhi) – ITA Nos. 621, 627, 628, 629, 671, 674 & 675 of 2017

Facts

(i) The assessee-entity (GEP), a tax resident of USA and part of GE Group, was engaged in the business of manufacture and offshore sale of highly sophisticated equipments such as gas turbine parts and sub-assemblies. GEIOC, another GE group company incorporated in USA, set up a liaison office in 1991 in New Delhi with permission of the Reserve Bank of India only to act as a communication channel and not for carrying on any business activity. GEIIPL, a company incorporated in India and part of GE Group, was party to the Global Service Agreement with GEIOC for providing limited market support services to GE Group entities (including GEP), for which GEIIPL was remunerated on a cost-plus basis.

(ii) A survey under section 133A of the Act was conducted at GEIOC's premises at AIFACS, 1 Rafi Marg, New Delhi and it was concluded that GEIOC's liaison office started operating in India from July 1, 1987 and from the information available, it was seen that GEIOC had employed various persons and was sending these employees on assignments to GE entities located worldwide. From these premises, other entities, incorporated in India as well as non-resident entities of the GE group were also operating.

(iii) Based on documents available, the AO passed an assessment order holding that the assessee had a fixed place PE and DAPE in India. He deemed 10% of the value of supplies made to the clients in India as the profits arising from such supplies and attributed 35% of such profit to the assessee's PE in India. These findings were upheld by the CIT(A) as well.

(iv) On second appeal, the Tribunal also decided against the assessee. It observed that expatriates were deputed in India for undertaking the marketing activities / sale functions of the overall GE group and, accordingly, held that liaison office constituted assessee's fixed place PE. The Tribunal also held that 'GE India' comprising of expatriates / employees of overseas GE entities constituted dependent agency PE through GE India

(v) The Tribunal further held that the AO was correct in his approach in estimating total income (profit) at 10% of sales made in India due to unavailability of year-wise and entity-wise profits of GE overseas entities for the operations carried out in India. However, it estimated 26% of such profit (i.e., 10% of sales) in India, as attributable to the operations carried out by the PE in India, as against 35% estimated by the AO.

(vi) Aggrieved, the assessee filed an appeal before the High Court against the Tribunal's observation pleading [A] Non-existence of Fixed Place PE in India [B] Non-existence of Dependent agent PE in India and [C] Incorrect Attribution of profits to PE in India

Held

[A] With regards to fixed place PE in India

(i) The Court observed that the lower authorities had recorded the finding that GE India was located in the space leased by GEIOC in the AIFACS building, New Delhi which was at its constant disposal. This was further substantiated by the fact that specific chambers / rooms and secretarial staff were allotted to GE staff which was used for their work, thereby signifying the expression PE *vis-à-vis* continuity of space available.

(ii) The Court perused the relevant provisions of the Indo-US DTAA and OECD Model Tax Convention and placed reliance on the Apex Court decision in the case of *Formula One World Championship vs. CIT (2017) 394 ITR 80 (SC)* to hold that certain amount of space at the disposal of the enterprise which is used for business activities is sufficient to constitute a place of business and no formal legal right to use that place is required. It held that mere continuous usage of the place was sufficient if it indicated being at disposal. Thus, the Court held that as per Article 5(1) of the Indo-US DTAA, GE's overseas enterprises had a place of business in India.

(iii) Moreover, noting the Tribunal's findings regarding the process adopted by GE Group for business development which were divided into four steps namely: Stage 1 Pre-qualification; Stage 2 Bid/no bid and Proposal development; Stage 3 Bid approval and negotiations; and Stage 4 Final contract development and approval, the Court held that the process of sales and marketing of GE's product through its various group companies was not simple and entering into a contract with stakeholders involved a complex matrix of technical specifications, commercial terms, financial terms and other policies of GE. Thus, to address the same, GE had stationed several employees and officials at GE India.

(iv) Accordingly, the Court held that the assessees' employees were not merely liaisoning with the clients and the headquarters office and it highlighted that the core activity of GE India involved discussing the contractual terms and the associated consideration payable, etc. and though at later stages of contract negotiations, the India office could not take a final decision, and had to await the decision from the headquarters, the Court held that this did not indicate that the India office was just for mute data collection and information dissemination.

(v) Thus, the Court concluded that the discharge of vital responsibilities relating to finalisation of commercial terms etc., clearly revealed that GE carried on business in India through its fixed place of business through the premises. Thereby, it ruled in favour of the Revenue on the first issue.

[B] With regards to dependent agent PE in India

(vi) The assessee relied on OECD Commentary on Model Tax Convention (paragraph 33 on Article 5) which states that mere participation in negotiation does not lead to either a fixed place PE or a dependent agent PE and argued that the view taken by the Tribunal was not only contrary to the OECD Commentary but also to the UN Commentary on Model Tax Convention (paragraph 24 on Article 5).

(vii) The Court noted that India had clarified its position with respect to Para 33 of the OECD commentary stating that, "a person has attended or participated in negotiations in a State between an enterprise and a client, can, in certain circumstances, be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise; and that a person who is authorised to negotiate the essential elements of contract, and not necessarily all the elements, can be said to exercise the authority to conclude contracts". Further, it noted that the position in Para 32.1 of the said commentary (which states that lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent) runs contrary to the aforesaid Para 33 relied upon by the assessee and held that the assessee could not selectively quote from certain parts of the commentary and he must read the spirit of the entire commentary. The Court also held that since the OECD commentary appears to be contradictory across paragraphs 32 and 33, it could not be relied upon wholly.

(viii) The Court further rejected assessee's stand that the activities of agent must be devoted wholly or almost wholly to one enterprise and since expats were rendering services to multiple GE entities in India and were not working for a particular enterprise, it did not constitute dependent agent PE in India as per Article 5(5) of the Indo-US DTAA. The Court upheld Tribunal's conclusion that as long as the activities of the agent in concluding contracts was not auxiliary, and it did not require concluding every single element of the contract, the assessee's activities would establish Agency PE in India.

(ix) Further, the Court rejected the assessee's argument that the expatriates and employees of GEIIPL only participated in the negotiation for conclusion of contracts but never had the authority to finalise any contract on their own volition. It held that the fact that technical officials having varying degree of authority involved themselves – along with local managerial, in contract negotiation, often into core or "key" areas, modification of technical specifications and the negotiations for it, to fulfil local needs and even local regulatory requirements, the complexities of price negotiation, etc., clearly showed that the assessee carried out business through the PE in India.

(x) Accordingly, the Court ruled in favour of Revenue and upheld Tribunal's view that the nature of activities carried by GE India, clearly indicated its authority to conclude contracts on behalf of the overseas entities of GE Group, which signified that GE India constituted agency PE of all the GE Overseas entities in India.

[C] With regards to attribution of Profits

(xi) The Court noted that w.r.t. attribution of income, the AO had carried the exercise of attribution in two stages, viz., calculation of total profit from the sales made by GE overseas entities in India, which was worked out at 10% applying Rule 10(iii) and second, attribution of such profit to marketing activities, which was taken at 35% of 10% relying on the decision in the case of *Rolls Royce PLC vs. DIT(IT) (2011) 339 ITR 147 (Del. Trib.)* [wherein 35% of the profits from sales and marketing activities were attributed to PE in India].

(xii) The Court noted that the Tribunal had upheld the AO's stage 1 attribution of 10%. However, with respect to stage 2 attribution, the Tribunal had directed the AO to apply 26% of total profit in India as attributable to the PE, noting the nature of activities done by Rolls Royce in India in the said case was more than those done by GE overseas entities and further opining that the extent of activities by GE Overseas in making sales in India is roughly one fourth of the total marketing effort.

(xiii) Accordingly, the Court concluded that there was no infirmity in the approach adopted by the Tribunal and upheld the decision by the Tribunal.

3. In view of Section 253(2A), Revenue can file appeal against the DRP's directions only where the objections are filed by assessee on or after 1st July, 2012

Pr. CIT vs. Nomura Services India P Ltd [TS-9-HC-2019 (BOM)-TP] – ITA No. 1060 of 2016

Facts

(i) The assessee had filed objections before the DRP on 23rd December, 2010 against the draft order passed by the AO. The DRP rejected these objections on the grounds that it was defective. Against this decision, the assessee filed an appeal before the Tribunal.

(ii) The Tribunal held that the reasons for non-consideration of objections were incorrect and remanded the proceedings before the DRP for disposal of the assessee's objections on merits. Accordingly, the DRP passed fresh directions and directed exclusion of one comparable from the list of comparables selected by the TPO.

(iii) The legislature *via* Finance Act 2012, inserted sub-section (2A) to section 253 which granted right of an appeal to the Revenue against the directions of the DRP issued u/s. 144C(5) in respect of any objections filed on or after 1st July, 2012.

(iv) Relying on the aforesaid insertion, the Revenue filed an appeal against the fresh directions of the DRP. The Tribunal held the appeal was not maintainable since the objections were filed by the assessee before 1st July, 2012.

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

Held

(i) The Court confirmed the Tribunal's order holding that section 253(2A) was not applicable in the present case.

(ii) It rejected Revenue's contention that the date of remand by the Tribunal should be taken into consideration to ascertain the applicability of sub-section (2A) to section 253, holding such contention to be "wholly erroneous" as the Tribunal had merely held the objections were validly raised and had remanded the matter to the DRP to decide the objections on merits.

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

4. Tribunal made a mistake/error in not dealing with fundamental submissions, with respect to characterisation of distribution fees paid to AE as royalty, which was apparent from the record, in view of the fact that all the relevant details with respect to above issue were available before the Tribunal and it was not disputed that the said issue was raised before the Tribunal

Sony Pictures Networks India Pvt. Ltd. [TS-5-HC-2019(BOM)-TP] – Writ Petition No. 3508 of 2019

Facts

(i) The assessee was engaged in the business of distributing television channels in India [which was *inter alia* owned by its Associated Enterprises (AEs)] to Local Cable Operators (LCO), Multi System Operators (MSO) and Direct to Home Operators (DTO). The assessee retained 10% of the subscription revenue collected from the operators and the balance was paid to its AEs.

(ii) The TPO benchmarked the transactions between assessee and AEs by comparing it with seven comparables from the royalty data base and made a transfer pricing adjustment. The DRP gave a partial relief to the assessee by restricting the comparables to three comparables, consequently resulting in a lower transfer pricing adjustment.

(iii) The assessee filed an appeal before the Tribunal contending that the TPO had selected wrong comparables for benchmarking as the distribution fees paid to its AEs could not be characterised as a royalty in view of the fact that the assessee had no right over the content of broadcast. For this, it relied on jurisdictional High Court decision in the case of *CIT vs. SET India Pvt. Ltd. [ITA No. 1347 of 2013]*. The Tribunal did not deal with the fundamental dispute i.e., that the characterisation of distribution fee paid to its AEs are not payments in the nature of royalty and restored the issue of determining ALP back to the AO/TPO.

(iv) The assessee filed an application for rectification contending that the Tribunal should have addressed the aforesaid fundamental issue before restoring the issue of determining ALP back to the AO/TPO.

(v) It was not disputed that the aforesaid issue was raised before the Tribunal during the hearing. However, the Tribunal rejected the application on the grounds that the entire issue had been restored to the TPO for fresh adjudication including characterisation of fees and held that non-consideration of any argument made by a party would not lead to a rectification, relying on the decision in the case of *Commissioner of Income Tax vs. Ramesh Electrical Company Ltd [(1993) 203 ITR 497 (Bom)].*

(vi) Aggrieved, the assessee filed a writ petition before the High Court against the Tribunal's order disposing off the rectification application.

Held

(i) The Court held that since all facts with respect to the issue of character of distribution fees were available before the Tribunal, the Tribunal ought to have addressed the issue itself without remanding the same to the AO/TPO.

(ii) It distinguished the present case from *Ramesh Electrical (supra)* by holding that, unlike in that case, in the present case, the mistake/error in not dealing with the fundamental submission in appeal is apparent from the record, as the submission that the distribution fee was not royalty was recorded and yet not dealt with by the Tribunal in its order.

(iii) Accordingly, the Court allowed the petition by setting set aside the Tribunal's order and restoring the appeal to the Tribunal for fresh disposal in accordance with law.

C) Tribunal Decisions

5. Article 15 – Independent Personal Services – Payments of Professional Fees to foreign affiliates are non-taxable; 'Independent Personal Services' Article applicable to LLPs – In favour of the assessee

ACIT vs. M/s. Grant Thornton [TS-10-ITAT-2019 (Del.)] Assessment Year: 2010-11

Facts

(i) Grant Thornton ('assessee'), a partnership firm is engaged in providing international accountancy and advisory services to various clients in India and abroad. During AY 2010-11, the assessee had made payments for professional fees to non-residents firms, on which no tax was deducted at source. The services of the foreign firms were obtained to render services to foreign clients of the assessee in UK, USA, Netherlands and France etc.

(ii) It was contended by the assessee that fee paid to these firms was paid for services rendered outside India and same is covered by Article 15 "Independent Personal Services" of respective DTAA and in absence of any fixed base of the recipient in India, income was not chargeable to tax in India and thus no withholding tax was required to deduct on such payments u/s. 195 and consequently no disallowance u/s. 40(a)(i).

(iii) However, according to AO, services rendered by a non-resident (fee for 'technical nature') though having no residence or place of business or business connection in India or rendered outside India shall be deemed to accrue arise in India. The AO placed reliance on the Tribunal ruling in the case of Linklaters LLP and Ashapura Minichem Ltd.

(iv) On the issue of Article 15 of the respective DTAAs invoked by the assessee, the AO observed that the said article is applicable to an individual, whether in his own capacity or as a member of a partnership and in the instant case the parties are admittedly Limited Liability Partnership Firms (LLP) and not an individual, those are not covered by the benefit of Article 15 for "independent personal services" rendered. According to the AO, the services rendered being technical in nature the payment is Fee for technical services, which falls under Article 13 of the respective DTAA. Therefore, the AO made disallowance u/s. 40(a)(i).

(v) On further appeal, CIT(A) analysed the claim of the assessee of non-taxability of the payments in the hands of the non-resident in view of the Article 15 (Independent

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Personal Services) under respective DTAAs and concluded that income derived by an individual or a partnership firm by rendering professional services is taxable in the country of its residence. CIT(A) also examined taxability of the professional fee paid under Article 13 of various DTAAs and concluded that no technical knowledge was made available and thus in view of the "make available" clause in DTAAs, the payments were not in the nature of Fee for Technical Services. Therefore, the CIT(A) held that the assessee was not liable to deduct tax u/s. 195 and deleted the disallowance made by the AO u/s. 40(a)(i).

Decision

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

(i) The Tribunal noted the CIT(A)'s conclusion that there is no fixed base or office or permanent establishment (PE) of the said UK LLP in India. Therefore, CIT(A) held that in the absence of a PE / fixed base of the recipient (i.e., M/s. Grant Thornton UK LLP) in India and on account of the fact that no one from the said firm had even a single day stay in India, professional fees for rendering services in UK will be taxable only in UK and not in India.

(ii) The Tribunal noted that the CIT(A)'s had rejected the AO's conclusion that the impugned professional services were not covered under the Article on "Independent Personal Services" of DTAAs with UK and other countries on a flimsy ground that the said Article is applicable for professional fees paid to an individual only, whether in his own capacity or as a member of a partnership, and not to LLPs.

(iii) The Tribunal upheld the CIT(A)'s observation that in the case of DTAAs with USA, UK and France, it is unambiguously written in the said Article on "Independent Personal Services" itself that it is applicable on Income derived by a person who is an individual or firm of individuals; or by an individual, whether in his own capacity or as a member of a partnership; or by an individual or partnership of individuals. In the case of Netherlands, the word 'resident' is used in Article 14 on 'Independent Personal Services', and as per Article 4(1) of the said DTAA, the term 'resident of one of the States' means any person. Further, 'person' has been defined by Clause 1(e) as: "the term 'person' includes an individual, a company, any other body of persons and any other entity which is treated as a taxable unit, under the taxation laws in force in the respective States". Therefore, it upheld the CIT(A)'s conclusion that even in case of India-Netherlands, Article 14 on 'Independent Personal Services' is definitely applicable on the income derived by a partnership firm or an LLP.

(iv) It was held that in each of these DTAAs the term "professional services" includes the independent activities of 'lawyers' and 'accountants' amongst other such professional and the assessee is undisputedly engaged in rendering accounting and advisory services.

(v) The Tribunal also upheld the CIT(A)'s conclusion that in view of the various DTAAs that the services rendered by the those non-resident parties are not Fee for Technical Services on the ground that services rendered by the assessee are purely individual-based services of professionals. Therefore, since no knowledge was made available in the process of providing services by the non-resident parties to the assessee, the payment for services cannot be held as fee for technical services under the provisions of the respective DTAAs.

6. Article 23 of India – Thailand DTAA – Tax Treaty – Tax sparing credit is allowed under the India-Thailand tax treaty with respect to "Dividend" Income – In favour of the assessee

M/s. Polyplex Corporation Ltd. vs. ACIT [TS-30-ITAT-2019 (Del.)] Assessment Years : 2010-11 to 2013-14

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Facts

(i) The assessee, an Indian company, is having a wholly owned subsidiary in Thailand. During the assessment years 2010-11 to 2013-14, Thailand subsidiary declared dividend which was received by the assessee. By virtue of the Investment Promotion Act in Thailand, such dividend income was exempt in the hands of Thailand Company. However, the assessee claimed that as per Article 23(3) of the tax treaty it is entitled to claim tax sparing credit of deemed tax payable in Thailand against Indian tax payable.

(ii) The Assessing Officer (AO) held that the assessee had not paid actual tax in Thailand on such dividend income. It was exempt in Thailand by virtue of Investment Promotion Act of Thailand. The tax treaty provisions did not provide for tax benefit for tax which was not paid at all. Article 23(2) specifically allows relief against income which has been subjected to tax in both the countries. Since the tax was only paid in India, the question of double taxation of income did not arise. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Decision

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

(i) While relying on Commentary on UN Model Convention and Klaus Vogel Commentary the Tribunal observed that the concept of 'tax sparing credit' shall be applicable to the assessee, only if dividend income received by assessee is taxable in the hands of assessee as per the 'Thai tax laws' and exemption is available to the assessee either as per the 'Revenue Code of Thailand' or as per the 'Investment Promotion Act' in order to avail credit of such taxes spared in Thailand.

(ii) From a conjoint reading of the taxability of dividend income under Thailand Revenue Code and Investment Promotion Act, it was observed that the exemption was available to the assessee on such dividend income under Investment Promotion Act, which would have been otherwise taxable as per the Thailand Revenue Code at 10%. Therefore, as per Article 23(3) of the tax treaty, the assessee would be entitled to a credit of such taxes which were deemed to have been payable in Thailand. The assessee sought credit at 10 % on such dividend, which is the tax that would have been otherwise payable by the assessee in Thailand as per the provisions of the Thailand Revenue Code. The tax paid by the assessee on dividend income in India is at 30 per cent, which was more than tax payable in Thailand and therefore, there is no violation of provisions of Article 23(2) of the Tax Treaty.

Comments

The Delhi High Court in the case of *Pr. CIT vs. Krishak Bharati Cooperative Ltd. [2017] 80 taxmann. com 326 (Del.)* dealt with the allowability of tax sparing credit. The High Court while affirming the decision of the Tribunal held that where the assessee received dividend income from an Omani company on which it was not liable to pay any tax in Oman by virtue of exemption granted as per Omani tax laws to promote economic development, the assessee was entitled for tax credit for deemed dividend tax by virtue of provisions of tax treaty read together with clarifications issued by Sultanate of Oman. Further, It is important to note that the India-Thailand tax treaty has been amended in 2015 where the 'tax sparing credit' clause has been deleted. However, the above decision can be helpful to claim the benefit of the tax sparing credit under Indian tax treaties which have a similar 'tax sparing credit' clause. Some of the Indian tax treaties having 'tax sparing credit' clause are Singapore, Philippines, Russia, Bangladesh, etc.

7. India-France DTAA – Payment of Fees for Advisory Services

– Fees For Technical Services – Application of concept of "Make Available" by virtue of Protocol to India-France DTAA r/w definition of "Fees for Technical Services" appearing in Article 13 of India-UK DTAA – Whether concept of "Make Available" be applied to India-France DTAA – Held : Yes – In favour of the Assessee

M/s. Entertainment Network (India) Ltd. vs. JCIT [TS-767-ITAT-2018 (Mum)] Assessment Year : A.Y: 2011-12

Facts

(i) The assessee made remittance of ₹ 25,97,275/- to M/s. Phora Capital Advisors, France for professional services rendered. No tax was deducted from such remittance.

(ii) On being asked to explain as to why the said amount is not liable for TDS, the assessee submitted that M/s. Phora Capital Advisors is situated in France and does not have any permanent establishment in India and they have provided only professional services to the assessee. It was further submitted that M/s. Phora Capital Advisors was a French company and not liable to tax in India and therefore, no disallowance u/s. 40(a)(i) is required to be made.

(iii) However, the Assessing Officer observed that assessee has claimed the services rendered as professional services but the services are in nature of advisory services to review the strategic and which is clearly a specialised services requiring technical knowledge for which Article 13 of Double Taxation Avoidance Agreement [DTAA] between India and France would be applicable. Therefore, in view of the Article 13 of DTAA between India and France assessee was required to withhold the tax under the relevant provisions of the Act. Accordingly, the Assessing Officer disallowed ₹ 25,97,275/- u/s. 40(a)(i) of the Act for non-deduction of tax at source u/s. 195 of the Act. The CIT(A) agreed with the A.O.

(iv) The assessee submitted that the payment was made overseas for the professional services rendered by M/s. Phora Capital Advisors which has no permanent establishment in India and the services rendered by M/s. Phora Capital Advisors are not technical services and therefore, does not fall under fees for technical services.

(v) The assessee further submitted that the expression "Fees for Technical Services" appearing in the DTAA between India and France, by virtue of the protocol that forms an integral part of the said DTAA, read with the definition of "Fees for Technical Services" appearing in the DTAA between India and UK, has also to be given a restrictive meaning. It was submitted that the "make available" clause appearing in the DTAA between India and UK, which has been entered into after 1st September, 1989, has therefore, to be read into as forming part of the definition of "Fees for Technical Services" appearing in the DTAA between India and France, from the date the DTAA between India and UK was entered into.

(vi) The assessee placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT vs. ISRO Satellite Centre [218 Taxman 74]* and submitted that, even assuming that it is technical services that should be made available to assessee and since no technical services were made available to the assessee no deduction is liable to be made for not withholding tax. Reliance was also placed on the decision of the Hon'ble Delhi High Court in the case of *Steria (India) Ltd., vs. CIT [386 ITR 390]* and submitted that a similar view has been taken by the Hon'ble Delhi High Court.

(vii) Therefore, the assessee submitted that since M/s. Phora Capital Advisors do not provide any technical services particularly they have not made available to the assessee, in view of the Clause (7) protocol under DTAA between India and France no tax is required to be made by the assessee and therefore, there shall not be any disallowance u/s. 40(a)(i) of the Act.

Decision

On Appeal, the Tribunal observed and held in favour of the assessee as follows:

(i) The Tribunal held that definition of the expression "Fees for Technical Services' appearing in the DTAA between India and U.K. that the scope and ambit of the term "Fees for Technical Services" is more restrictive than the definition of the said expression in the DTAA between India and France. The DTAA between India and UK contains a "make available" clause, for a service to constitute "Technical Service". This Clause has been interpreted by the Hon'ble Karnataka High Court in *CIT vs. DE Beers India Minerals Pvt. Ltd. (346 ITR 467)* and by the Hon'ble Delhi High Court in *DIT vs. Guy Carpenter Pvt. Ltd. (346 ITR 507)* to mean that the knowledge, experience, skill, knowhow etc., should pass on to the recipient so that in the future the recipient can carry out this service on his own.

(ii) In other words, the provider of the service, must "make available technical knowledge, experience, skill, knowhow or processes", to the person to whom the service is rendered in order for it to fall within the definition of "Fees for Technical Services".

(iii) The interpretation of the Article on "Fees for Technical Services" appearing in the DTAA between India and France has been considered by the Hon'ble Karnataka High Court in *CIT vs. ISRO Satellite Centre (218 Taxman 74) (Kar).*

(iv) The Hon'ble Delhi High Court in *Steria (India) Ltd. vs. CIT (386 ITR 390)* was concerned with more or less identical set of facts. The Court also examined the DTAA between India and France. After referring to the Protocol and Clause 7 of the Protocol, the Hon'ble Court held that there is no need for the Protocol itself to be separately notified and that the benefit of a more restrictive scope of a definition of "Fees for Technical Services", under a DTAA signed after 1st September 1989 between India and an OECD Member, is to be extended to the same definition under the DTAA between India and France. In the said decision also, the Hon'ble Court held that no tax was to be withheld under Sec. 195 of the Act on the remittance of FTS.

(v) Following the above decisions of the Karnataka High Court and the Delhi High Court, the Tribunal held that under the DTAA between India and France, the definition of "Fees for Technical Services" has to be given a restrictive meaning similar to that of the expression "Fees for Technical Services" appearing in the DTAA between India and U.K. Thus, reading the definition of "Fees for Technical Services" appearing in the DTAA between India and France, the advisory services rendered by M/s. Phora Capital Advisers to the assessee do not "make available" any "technical knowledge, experience, skill, knowhow or processes" to the Assessee company since, the Assessee company would have to go back to Phora Capital Advisors even in the future for availing similar advisory services.

(vi) Consequently, in the absence of the professional services provided by Phora Capital Advisors "making available" any "technical knowledge, experience, skill, knowhow, etc." to the assessee company, the remittance made to them was not chargeable to tax in view of the beneficial provisions under the DTAA and no tax was deductible at source on the said remittance. In the circumstances, the remittance of ₹ 13,04,364/- made to M/s. Phora Capital Advisors being not chargeable to tax in India, there was no requirement to deduct tax at source on the said remittance. Hence Assessing Officer is directed to delete the disallowance made under section 40(a)(i) of the Act.

8. NCLT approves scheme involving merger of promoter

holding companies into listed company rejecting the tax evasion allegations raised by income-tax authorities

Scheme of amalgamation between PIPL Business Advisors and Investments Private Limited and GSPL Advisory Services and Investment Private Limited and NIIT Technologies Limited – Company Petition CAA – 385/ND/2017 connected with CA (CAA) – 83(ND) of 2017

Facts

(i) NIIT Limited (Transferee Company or NIIT), an Indian Company listed on BSE and NSE is engaged in the business of rendering management services including skills and talent development, learning management and training delivery solutions.

(ii) PIPL Management Consultancy and Investment Private Limited (PIPL) and Global Consultancy and Investment Private Limited (GCIPL) were holding companies of the promoters incorporated on 1st March 2016 and held ~15.23 per cent and ~15.56 per cent equity shares in NIIT, respectively (hereinafter, PIPL and GCIPL are jointly referred to as transferor companies).

(iii) Transferor Companies had received shares of NIIT pursuant to gift from other Promoter Holding Companies during FY 2016-17. Further, 100% shareholding of the Transferor Companies in turn was held by the Promoter Family Trusts.

(iv) In the past, Promoter Family Trusts being the indirect acquirers of NIIT had sought approval of SEBI under Takeover Code Regulations.

(v) A Scheme of Arrangement involving merger of Transferor Companies with NIIT was filed before Delhi bench of NCLT for approval. The appointed date of the Scheme was 31st March 2017.

(vi) Salient features of the Scheme were as follows:

- Rationale of the Scheme: To simplify the shareholding structure by reducing the tiers of shareholding and streamlining Promoter's shareholding in NIIT pursuant to succession planning of the Promoters.
- Investments held by the Transferor companies in NIIT stood cancelled and shares of NIIT were issued to the shareholders of Transferor Companies viz., the Promoter Family Trusts in the same proportion as their shareholding existed in Transferor companies prior to merger. Accordingly, there was no change in the shareholding pattern pursuant to the scheme.

(vii) Objections raised by Income-tax Authorities

Income-tax authorities raised various objections in their replies submitted to the NCLT. Summary of key objections and observations were as follows:

a) Pre-ordained series of transactions were undertaken to bypass legal provisions and evade capital gains tax liabilities.

b) Scheme involved effective transfer of shares of NIIT from the Transferor companies to the Family Trusts by misusing provisions of section 47 of the Act.

c) Transferor and Transferee companies were not in any way benefitted by the restructuring exercise and the scheme was solely for the benefit of Promoter Family Trusts.

d) The Scheme had been formulated w.e.f. 31st March 2017 to avoid tax liability under section 56(2)(x) that was introduced w.e.f. 01st April 2017.

Decision

NCLT observed and held as under:

(i) Where a scheme is up for sanction, role of Income-tax Authorities is limited to object only in case the Scheme is being created with the sole purpose of avoiding tax liability and the onus of proving the same lies on the Income-tax Authorities.

(ii) Concept of 'Tax mitigation', 'Tax evasion', 'Acceptable tax avoidance' and 'Abusive tax avoidance' based on past judicial rulings discussed in detail. High Court of Delhi in the matter of *CIT vs. Shiv Raj Gupta (ITA No. 41 of 2002)* and Supreme Court in the matter of *Vodafone International Holdings vs. UOI (341 ITR 1 (SC).*

(iii) Based on the principle laid down in SC ruling in the case of Vodafone International Holdings, assessee's right to arrange their affairs and structure the transactions in a beneficial way within the confines of law has been upheld. Gujarat High Court decision in the case of *Wood Polymer Limited (109 ITR 177)* cited by Income-tax Authorities is no longer good in law.

(iv) Equity shares of NIIT are not being transferred and the same shall be held by the existing promoters through their Family Trust which was previously being held through the Transferor Companies. Bombay High Court ruling in the case of AVM Capital Services Private Limited (Company Scheme Petition No. 670 of 2011) wherein on similar facts promoter Holding Company was merged with Listed Company, is squarely applicable in the current fact pattern.

(v) Despite having granted sufficient opportunity, Income-tax Authorities could not demonstrate "tax evasion" pursuant to gift of shares undertaken in the past. NCLT also observed that gift of shares was completed in FY 2016-17 and the same was permissible under the erstwhile tax laws.

(vi) SEBI approval under Takeover Regulations was duly obtained by the Family Trusts and amendments sought by SEBI in the Trust Deed were duly effected to ensure that the additional beneficiaries of the Trusts shall always be lineal descendants of Founder Trustees.

(vii) Per the SC decision in the case *Income Tax vs. Vodafone Essar Gujarat Ltd. (Civil Application No 29819/2012)*, interest of revenue needs to be protected for recovery of taxes.

(viii) As per the NCLAT ruling in the case of *MBS IT Institute Pvt Ltd vs. ROS Infratech and Housing Pvt. Ltd.* (Company Appeal No. 194 of 2017), "Appointed Date" of the Scheme can be postponed by NCLT only in a case there is ground to demonstrate the same.

(ix) Contention of the Income-tax authorities that the Scheme had been undertaken for the purpose of tax evasion is rejected and the scheme is approved. The Scheme did not propose transfer of shares of NIIT as effectively the same would continue to be held by the existing promoters through Family Trusts who previously held the same through Transferor companies.

(x) Jurisdiction of Income-tax Authorities in relation to recovery of any statutory dues from the Transferor Companies/ Transferee Company/ any other person liable for payment of tax is not impacted by the merger.

(**Remarks** : Recently, Mumbai NCLT had rejected a similar scheme in the matter of **Scheme of Amalgamation between Gabs Investment Private Limited and Ajanta Pharma Limited-CSP No. 995 of 2017 and CSP No. 96 of 2017** on grounds of tax evasion, creating uncertainty on tax neutrality of Promoter holding company mergers.)

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CA Jatin Harjai

INDIRECT TAXES

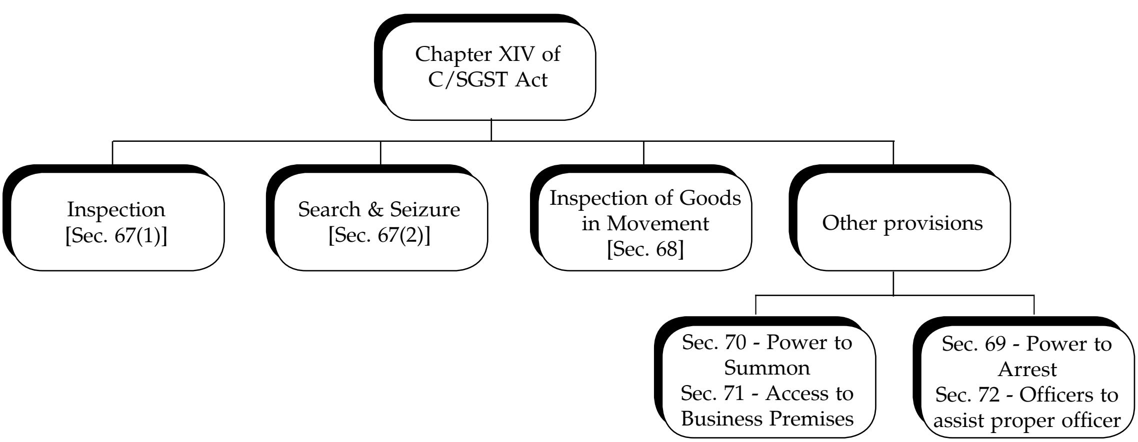
GST Gyan

Walk-through with Inspection, Search & Seizure under GST Law

A. Introduction

Inspection refers to careful examination, scrutiny or study of some document or object(s). Whereas search refers to examination of place or person with object of unearthing or discovering some information or evidences which are suspected to be hidden. Power of inspection, search and seizure are very strong investigation tool in the hands of revenue authorities, which gives enormous opportunity to gather evidences and unearth suppressed things and information so as to identify evasion of payment of tax and/ or contravention of any provisions of the law. However, such an action is having an effect of interfering into one's independence in addition to having a chances of hampering business activities to some extent, hence normally these powers are exercised as a last resort of gathering information. To safeguard interest of revenue robust powers are given to authorities under GST Law, simultaneously for protection of law abiding and honest tax payers, reasonable checks and balances are also there in place.

The provisions of Sec. 67 to 72 of the Central/ State Goods and Services Tax Act 2017, and Rule 139 to Rule 141 of C/SGST Act deals with powers and procedure of inspection, search & seizure. **This article is an attempt to compile and explain provisions of Inspection, search and seizure (other than inspection of goods in movement).** Summary of provisions is as under:



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Provisions of GST law are similar but not exactly same as that of pre-GST laws. Sec. 67 provides for inspection as well as search & seizure of goods. Inspection is much softer version of search & seizure and is similar to Survey as enumerated u/s 133A of the Income-tax Act, 1961.

B. Initiation of Inspection Proceedings

Sec. 67(1) reads as under

"Where the proper officer, not below the rank of Joint Commissioner, has reasons to believe that;

a. a taxable person has suppressed any transaction relating to supply of goods or services or both or the stock of goods in hand, or has claimed input tax credit in excess of his entitlement under this Act or has indulged in contravention of any of the provisions of this Act or the rules made thereunder to evade tax under this Act; or

b. any person engaged in the business of transporting goods or an owner or operator of a warehouse or a godown or any other place is keeping goods which have escaped payment of tax or has kept his accounts or goods in such a manner as is likely to cause evasion of tax payable under this Act,

he may authorise in writing any other officer of central tax to inspect any places of business of the taxable person or the persons engaged in the business of transporting goods or the owner or the operator of warehouse or godown or any other place."

Some of key aspects of above provisions are as under:

- Authorisation of inspection has to be given by the officer of the rank of Joint Commissioner or above.
- Authorising officer must have Reason to Believe about
  - o Taxable person –
    - – Suppressing of any transaction; or
    - – Suppressing Stock in hand; or
    - – Claiming of excess Input Tax Credit; or
    - – Indulging in contravention of any of the provisions of the law to evade tax; or
  - o transporter is keeping the goods which has escaped tax or has kept his accounts or goods in such a manner as is likely to cause evasion of tax
  - o operator of warehouse or godown or any other place is keeping the goods which has escaped tax or has kept his accounts or goods in such a manner as is likely to cause evasion of tax
- Authorisation should be in writing in Form No. GST INS-01, for Inspection.
- Inspection can be of Place of Business only.

Place of Business has been defined in Sec. 2(85) to include godown or any other place where a taxable person stores his goods, maintain his books of account and place of agent. Accordingly, if books of account are being maintained or kept at residence of director or any other key managerial person the same shall be treated as place of business and inspection can be carried out there.

C. Initiation of Search & Seizure Proceedings

Sec. 67(2) reads as under

*"where the proper officer, not below the rank of Joint Commissioner, <u>either pursuant to an inspection carried out under sub-section (1) or otherwise, has reasons to believe</u> that any **goods liable to confiscation or any documents or books or things**, which in his opinion shall be useful for or relevant to any proceedings under this Act, **<u>are secreted in any place</u>**, he may authorise in writing any other officer of central tax to search and seize or may himself* **search and seize** *such goods, documents or books or things."*

Some of key aspects of above provisions are as under:

- Authorisation of Search & Seizure has to be given by the officer of the rank of Joint Commissioner or above.

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- Authorising officer must have **Reason to Believe** about
  - o Goods liable for confiscation are secreted in any place
  - o Books, documents or something, which is useful or relevant for proceeding under GST law, are secreted in any place
- Authorisation should be in writing in form GST INS-01 for Search.
- In case of Seizure, Order of Seizure is to be issued in form GST INS-02.

In search & seizure proceedings goods which are liable for confiscation can only be seized. As per Sec. 130(1) of the C/SGST Act, following goods are liable for confiscation, under the law:

(i) If supply is made in contravention of any of the provisions of GST law with intention to evade payment of tax, or

(ii) If goods are not accounted for on which tax is liable to be paid or

(iii) If goods liable to tax are supplied without having applied for registration *(30 days time limit is there for applying registration, from the date person becomes liable for paying tax).*

D. Difference between Inspection & Search

Aspect	**Inspection – Sec. 67(1)**	**Search – Sec. 67(2)**
Primary Purpose	Verification of transactions of supplies, stock in hand, claim of ITC & contravention of provisions of the Act to evade tax.	Unearthing of goods liable for confiscation or secreted books, documents or things.
Scope	Inspection can be done at **Place of Business** only	Search can be done at **Any Place** including residence of tax payer and/ or employees.
Powers	Forceful action (Sealing or Break Open) cannot be adopted.	Seal or Break Open the door of any premises or break open any almirah, electronic devices, box, receptacle in which any goods accounts, registers or documents of the person are suspected to be concealed, where access to such premises, almirah, electronic devices, box or receptacle is denied, can be resorted.
Seizure of Goods	Goods cannot be seized in inspection proceedings.	Goods can be seized if they are liable for confiscation. If not practically possible to seize, constructive seizure can be there.
Seizure of Books of Account/ Documents	Books/ documents cannot be seized in inspection proceeding.	Any secreted document, books or things, which may be useful or relevant to any proceedings can be seized.

E. Reason to believe

It is very well evident from the provisions of Sec. 67 that Proper Officer (JC or above) must have reason to believe before authorising any action of Search & Seizure and Inspection as well. Term 'reason to believe' is not defined under the GST law, however defined in Indian Penal Code 1860. Further the scope of the said term is more or less settled under Income Tax Law. As per sec. 26 of IPC *"A person is said to have "reason to believe" a thing, if he has sufficient cause to believe that thing but not otherwise"*. That means there is very less room for any doubt or ambiguity. Reason to believe refers to a positive, strong and firm opinion based on information and evidences. It is definitely a subjective matter which may vary from case-to-case, however 'Reason to believe is not same as that of reason to suspect' *(Indian Oil Corporation – 159 ITR 956 SC).*

Hon'ble Supreme Court in the case of *'Lakhmani Mewal Das (103 ITR 437)'* has held that the reason for the formation of the belief must have rational connection with or relevant bearing on the formation of the belief. The rational connection postulates that there must be direct nexus or live link between the material coming to the notice of the Income-tax Officer and the formation of this belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts.

The Hon'ble Court further held that it is no doubt true that the Court cannot go into sufficiency or adequacy of the material substitute its own opinion for that of the Income-tax officer on the point as to whether action should be initiated for reopening assessment. At the same time we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and farfetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment. The fact that the words "definite information" which were there in section 34 of the Act of 1922, at one time before its amendment in 1948, are not there in section 147 of the Act of 1961, would not lead to the conclusion that action can now be taken for reopening assessment even if the information is wholly vague, indefinite, far-fetched and remote. The reason for the formation of the belief must be held in good faith and should not be a mere pretence.

F. Power to Summon & Recording of Statements

As per Sec. 70 of the C/SGST Act proper officer(s) under the law have the power to summon any person whose attendance he considers necessary either to give evidence or to produce a document or any other thing in any inquiry. The summon can be given for giving evidence by way of statement on oath or production of any books of account, documents or other things. However, summons can be issued only during pendency of any enquiry under the law. While exercising powers to issue summons provisions of the Code of Civil Procedure, 1908 shall apply and such enquiries shall be deemed as 'Judicial Proceedings' u/s 193 & Sec. 228 of IPC. That means if anyone intentionally gives false evidence in response to summon issued u/s. 70, or fabricates false evidence for the purpose of being used in any stage of such enquiry, may be punished with imprisonment which may extend to seven years, and shall also be liable to fine.

Refreshing Memories: At the time of recording of statement, it is quite possible that a person doesn't have exact knowledge of facts and/or figures or might have forgot the same. In such a case the documents can be referred to refresh memory and statements can be given accordingly. As per sec. 59 of the Indian Evidence Act 1872, *"a witness may, while under examination, refresh his memory by referring to any writing made by himself at the time of the transaction concerning which he is questioned, or so soon afterwards that the Court considers it likely that the transaction was at that time fresh in his memory. The witness may also refer to any such writing made by any other person, and read by the witness within the time aforesaid, if when he read it he knew it to be correct.*

Presence of Counsel during statements: As regards to presence of advocate at the time of taking statement by tax authorities, it has been held that it is not a right of the taxpayer to have its counsel along with him. However, looking to the medical or other conditions the counsel may be allowed to attend the proceedings, however no consultation is allowed at the time of recording the statements. *Hon'ble Apex Court in the case of 'Poolpandi vs. Sup. Central Excise (60 ELT 24)"* while holding the same ratio observed as that *"The purpose of the enquiry under the Customs Act and the other similar statutes will be completely frustrated if the whims of the persons in possession of useful information for the departments are allowed to prevail.*

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For achieving the object of such an enquiry if the appropriate authorities be of the view that such persons should be dissociated from the atmosphere and the company of persons who provide encouragement to them in adopting a non-cooperative attitude to the machineries of law, there cannot be any legitimate objection in depriving them of such company. The relevant provisions of the Constitution in this regard have to be construed in the spirit they were made and the benefits thereunder should not be expanded to favour exploiters engaged in tax evasion at the cost of public exchequer."

Discipline for issue of Summons: Issue of summon in any inquiry, to witness or give evidence should be reasonable and not arbitrary. The authority issuing the summons must issue summons to a witness only when the authority considers it necessary for summoning. This necessarily implies application of mind and is guided by the principles of reasonableness in the matter of summoning of witness. Guiding force for issuing summon should be 'necessity of witness for the purposes of inquiry'.

Hon'ble Jharkhand High Court in the case of *Sudhir Deora vs. CCE (284 ELT 326)* had observed that it is quite possible that the senior most officers like managing director or General Manager, who are at the helm of the affairs of the company might not be having knowledge of minute operational things. The Hon'ble Court held that Enquiry Officer should keep in mind that he being an Officer authorised by law to summon anybody does not make him an Officer having no control of reasonableness and though he has right to summon any person either the Managing Director or the General Manager of the company or even a clerk of the company but he should not summon unless it is required for the purpose of an inquiry.

G. Inspection of Business Premise

Sec. 71 of the C/SGST Act provides for access to **place of business** by the officers authorised by the proper officer not below the rank of Joint Commissioner. The purposes of such access to business premises may be audit, scrutiny or verification to ensure safeguard interest of the revenue. In such cases person in-charge of place of business shall be under an obligation to make available books of account, financial statements, income tax audit report (if any), cost audit report under companies law (if any) and any other relevant records for examination and verification. These powers can be exercised by auditor appointed u/s. 66 as well. It is pertinent to note that the term audit as defined in sec. 2(13) of C/SGST Act includes examination and verification of records and documents maintained under provisions of GST law or **under any other law** for the time being in force, that means authorised officer or special auditor may ask for records which are mandated to be kept under GST law. For example, in case of mining company, records made under mining law can be asked for and in case of a hotel the records of guest (or guest register) can be asked for verification and examination to ascertain proper disclosure as regards to supply of goods or services and payment of taxes thereon.

H. Arrest (Sec. 69)

GST law provide officers power to arrest a person. Arrest is considered as strongest enforcement right as it breaches fundamental right of a person of freedom. The authorisation to arrest can be issued by Commissioner only, that too when he has reason to believe that such person has committed specified offence which is punishable u/s. 132(1)(i)/ (ii) or Sec. 132(2) of the C/SGST Act.

Specified offences are:

- Supply of goods or services without issue of invoice, with the intention to evade tax.
- Issue of invoice without supply of goods or services which leads to wrongful availment of ITC or refund of taxes.
- Availment of ITC on the basis of invoices for which actual supply has not been made.
- Failure in payment of tax after collection for more than three months.

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Punishments covered:

Section	Description of Offence	Punishment
132(1)(i)	Tax Evaded/ ITC Excess Claimed/ Refund wrongly taken > INR 5 Cr.	Imprisonment up to 5 years with fine
132(1)(ii)	Tax Evaded/ ITC Excess Claimed/ Refund wrongly taken > INR 2 Cr. & up to INR 5 Cr.	Imprisonment up to 3 years with fine
132(2)	Conviction of person already convicted (irrespective of amount)	Imprisonment up to 5 years with fine

It is important to note that authorisation of arrest can be done only and only when the offence is among the specified category **and** is punishable as mentioned above. Further, in case of punishment u/s. 132(1)(ii) & Sec. 132(2) the offence is non-cognizable & bailable, that means arrest cannot be done without warrant from court and bail is to be granted as a matter of right. On the contrary in case of punishment u/s. 132(1)(i) the offence is cognisable & non-bailable, that means arrest can be made by the authorised officer without authorisation from court and the bail cannot be taken as a matter of right and has to be taken from court.

I. Release of books/Documents seized

Books of accounts, documents or other things seized u/s. 67(2) are to be kept with proper officer till the time they are required for verification or examination for enquiry or proceedings under the GST law. However, after issue of notice if some documents, books or things seized are not relied upon for issue of notice the same shall be returned within 30 days from the date of issue of notice. However, person from whom documents are seized shall be entitled to make copies thereof or take extracts therefrom in the presence of an authorised officer at such place and time as such officer may indicate in this behalf except where making such copies or taking such extracts may, in the opinion of the proper officer, prejudicially affect the investigation.

J. Release of goods seized

Sec. 67(6)/(7), Rule 140

Goods seized at the time of search can be released on payment of applicable tax, interest and penalty. Alternatively the goods seized can be released provisionally on furnishing of:

- Bond in Form No. GST INS-04 for value of the goods, declaring that goods shall be produced as and when required by the proper officer and any tax, interest, penalty, fine or other law full charges shall be paid within ten days of their demand in writing AND
- Security in the form of bank guarantee equivalent to the amount of tax, interest and penalty payable in respect of such goods.

If goods are seized in any search and no notice in respect thereof is given within six months of the seizure of the goods, such goods shall be released to the person from whose possession they were seized.

K. Seizure of perishable/ hazardous Goods

Sec. 67(8), Rule 141, Notification No. 27/2018(CT) Dt. 13-6-2018

If the goods seized under any search proceedings are perishable or hazardous in nature (as notified) the same shall be disposed of by the proper officer as soon as possible after its seizure. If the taxable person pays lower of 'market price of such goods' or 'demand (including interest and penalty), which is payable or may become payable, by the tax payer' such goods shall be released to him after passing the order in Form GST INS-05. If the tax payer doesn't pay the amount as stated above the Commissioner will dispose off such goods and realisation proceeds shall be adjusted against tax, interest, penalty or any other amount payable in respect of such things.

Major goods notified for purposes of Sec. 67(8) i.e., to be treated as perishable or hazardous includes newspaper, batteries, petroleum products, fireworks, chemicals, drugs, unclaimed technology driven goods, all goods covered under chapters 1 to 24 of the Customs Tariff Act, 1975 i.e. all animals and vegetables and products made from them.

L. Jurisdiction for Inspection, Search & Seizure

GST is a unique tax law from the aspect that its first time when State and Central Governments are Levying & Collecting tax on same taxable event simultaneously. It poses challenges before the Government for administration of assessees as well. To address this challenge, Sec. 6 was inserted in both the enactments i.e., State and Central to provide for cross empowerment, so that Central Tax Officer can have jurisdiction under State Tax and *vice versa* too. However, due to enabling cross jurisdiction by sec. 6, every taxpayer gets covered by two jurisdictional authorities. Whereas, as enumerated by Government many times, the idea was to have single jurisdiction (or interface) for all administrative purposes. In the 9th GST Council meeting held on 16th January 2017, to ensure its objective of single interface under GST State and Central Government decided to share taxpayer base, for all administrative controls, between them in the ration of 90 : 10 for small taxpayers and 50 : 50 for other tax payers. Apart from the same it was decided that both the Central and the State tax administrations shall have the power to take intelligence-based enforcement action in respect of the entire value chain. However, in the afterward meetings of GST Implementation Committee (GIC), on 25th August and 31st August 2017, the matter in relation to principles for division of taxpayers between the centre and the states i.e., cross empowerment were discussed and laid before GST Council again in its 21st meeting held on 9th September 2017, whereby the same was approved. For implementation of its decisions of cross-empowerment GST council issued a Circular No. 1/2017 dated 20-9-2017 mentioning its decision and principles for cross empowerment under GST for all administrative purposes. On the basis of this circular State GST Commissioners and Chief Commissioner of Central Taxes issued joint orders for cross-empowerment, whereby it was specifically written that to ensure single interface taxpayers are divided between State and Centre for all administrative controls/ purposes. **It is evident from documents of above meetings and circular that, intelligence based enforcement action was only discussed in 9th GST Council meeting and after that neither covered in 21st GST Council meeting nor the same was covered in authoritative documents released for cross-empowerment of the assessee's i.e. Circular No. 1/2017 of GST Council and Cross Empowerment Order(s) of respective States.** On the contrary some State Commissionerate(s) have issued letters/ instructions that intelligence based actions can be taken by both authorities i.e. State and Centre. The premises of such understanding under these letters is only and only decisions taken in 9th GST Council meeting. It nowhere discusses agenda, discussions and decisions in 21st meeting of GST Council and how decisions taken in 9th GST Council meeting have been implemented i.e. through which authoritative document having force of law.

From above analysis, *prima facie* it appears that as on date Central Tax authority can exercise jurisdiction for all purposes (including search and seizure) under both the enactments i.e. state Tax and Central Tax for assessee's assigned to it only. And on the same line for assessee's assigned to State, all actions can be taken up by State Tax Authorities only. Since this understanding is neither synchronised with how actually inspections and searches are carried on by both departments, nor with what was decided in 9th Council Meeting, in times to come it will be interesting to see how Courts decide the fate of jurisdiction aspect in intelligence-based enforcement actions.

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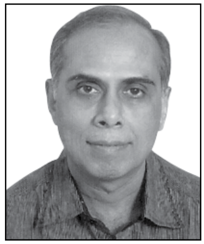

CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES

GST – Legal Update

NOTIFICATIONS

Provisions relating to Advance Authorization amended to mandate CA certificate *[Notification No.1 /2019-CGST, dt. 15-1-2019]*

Notification 48/2017-CGST, dt. 18-10-2017 amended to add proviso to Entry 1 to mandate requirement of CA certificate for supply of goods against advance authorisation when exports have already been made after availing input tax credit on inputs used in manufacture of such exports. Such certificate to be submitted with jurisdictional Commissioner of GST within 6 months of such supply.

Appoints 1-2-2019 as effective date for CGST (Amendment) Act, 2018 *[Notification No.2/2019-CGST, dt. 29-1-2019]*

CGST (Amendment) Act, 2018 shall come into force from 1-2-2019 except for following sections of CGST (Amendment) Act, 2018

- Sec. 8(b) –Amendment to Sec. 16(2)(c) relating to ITC
- Sec. 17 – Amendment to Sec. 39 relating to furnishing of returns
- Sec. 18 – Insertion of Sec. 43A relating to procedure for New return scheme and availing ITC
- Sec. 20(a) – Amendment to Sec. 49(2) relating to payment of tax, interest, penalty and other amounts
- Sec. 28(b)(i) & 28(c)(i) – Amendment to Explanation 1 and 2 to Sec. 140 relating to transitional credit

(Similar Notification No. 1/2019 – dt. 29-1-2019 issued under IGST, UTGST and Compensation Cess)

Amendment to CGST Rules, 2017 *[Notification No.3/2019-CGST, dt. 29-1-2019]*

CGST (Amendment) Rules, 2019 applicable w.e.f. 1-2-2019 are as under:

- Heading of Chapter II **"Composition Rules"** substituted to **"Composition Levy"**
- **Rule 7: Rate of tax for composition levy**

  Rate of tax in entry 3 amended to provide that CGST applicable @ 0.5% of turnover of taxable supplies of goods and services in the State or UT.
- **Rule 11: Separate registration within a State**

  "Multiple business vertical" is substituted with "multiple place of business".

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Accordingly, a person having multiple place of business within the State may apply for separate registration whether or not it is a separate business vertical.

- **Rule 21A: Inserted to provide for "Suspension of Registration"**

  Date of suspension of registration shall be the date of submission of application or the date from which cancellation is sought whichever is later. During the period of suspension, the registered person shall not make any taxable supplies and shall not be required to file any returns.

- **Rule 41A: Inserted to provide for "Transfer of Credit on obtaining separate registration for multiple place of business within the state or UT"**

  Form GST ITC-02A (format prescribed) shall be filed electronically in this regard within 30 days from the date of obtaining separate registrations. The transferee shall accept such credit and thereafter the same shall be credited to transferee's Electronic Credit Ledger.

- **Rules 42& 43: Manner of distribution of ITC and reversal thereof**

  – Explanation to Rule 42(1)(i) and 43(1)(g) amended to provide that aggregate value of exempt supplies and the total turnover shall exclude tax or duty paid covered under Entry 92A of List I of the Seventh Schedule to the Constitution (taxes on sale or purchase of goods in the course of inter-state trade or commerce).

  – Clause (a) to Explanation to Rule 43(2) excluding value of supply of services specified in Notification 42/2017 IGST(Rate) dt. 27-10-2017 from value of exempt supplies is omitted.

- **Rule 53: Revised tax invoice and credit or debit notes**

  Sub-rule (1A) inserted to prescribe particulars of debit or credit notes. Consequently, the same is omitted from sub-rule (1).

- **Rule 80: Annual Return**

  Sub-rule (3) amended to exempt department of CG or SG or a local authority, whose books of account are subject to audit by CAAG of India or an auditor appointed for auditing the accounts of local authorities under any law for the time being in force, from audit under GST.

- **Rule 83: Provisions relating to GST practitioner**

  – Sub-rule (3) amended to extend time limit for passing examination by GST practitioner from 18 months to 30 months from the appointed date (up to 31-12-2019).

  – Sub-rule (8) amended to allow GST Practitioner to additionally carry out following activities on behalf of registered person:

    - furnish information for generation of e-way bill
    - furnish details of challan in Form GST ITC-04
    - file an application for amendment or cancellation of enrolment under Rule 58
    - file an intimation to pay tax under the composition scheme or withdraw from the said scheme
    - Rule 85 & 86: Electronic Liability Ledger & Electronic Credit Ledger

Rule 85(3) and Rule 85(2) amended to provide that payment of liability by utilisation of credit shall be subject to Sec. 49A and 49B inserted which provides for manner and order of utilisation of credit.

- **Rule 89: Application for refund of tax**

  Sub-rule (2)(f) substituted to provide that declaration is required from the person applying for refund to the effect that tax has not been collected from SEZ unit or developer of SEZ.

- **Rule 91, 92 & 94: Grant of provisional refund and order sanctioning refund and interest on delayed payments**

  – Proviso added to Rule 91(2) and Rule 94(4) to provide that order issued in Form GST RFD-04 and RFD-06 shall not be required to be revalidated by proper officer,

  – Proviso added to Rule 91(3) and Rule 92(4) to provide that payment advice in Form GST RFD-05 shall be required to be re-validated where refund is not disbursed within the same FY in which the said payment advice was issued.

- **Rule 96A: Refund of IGST paid on export of goods or services under bond or LUT**

  Sub-rule(1)(b) amended to allow receipt of consideration for export of services in Indian Rupees, wherever permitted by RBI.

Jurisdiction of Joint Commissioner (Appeals) defined *[Notification No.4/2019-CGST, dt. 29-1-2019]*

Notification No. 2/2017 – Central Tax, dt. 19-6-2017 is amended to define jurisdiction of Joint Commissioner of Central Tax (Appeals).

Alignment of rates for Composition Scheme with CGST Rules *[Notification No.5/2019-CGST, dt. 29-1-2019]*

Notification No. 8/2017 dt. 27-6-2017 amended to provide that rate of tax for composition levy will be as specified under Rule 7 of CGST Rules.

[Notification applicable w.e.f. 1-2-2019]

Threshold applicable to Special Category States *[Notification No.6/2019-CGST, dt. 29-1-2019]*

Notification No. 65/2017 dt. 15-11-2017 amended to give effect to amendment u/s 22(1) and Explanation (iii). Accordingly, the threshold exemption for special category states except for the States of Jammu & Kashmir, Arunachal Pradesh, Assam, Himachal Pradesh, Meghalaya, Sikkim and Uttarakhand of ₹ 10 lakh may be increased up to ₹ 20 lakh on the recommendation of the Council and subject to conditions and limitations as may be notified.

(Similar Notification No. 3/2019 dt. 29-1-2019 issued under IGST)

Extension of due date for TDS Return – Form GSTR 7 *[Notification No.7/2019-CGST, dt. 31-1-2019]*

Due date for filing of GSTR 7 for the period Oct-Dec., 2018 is extended up to 28-2-2019.

Regarding RCM on supplies from Unregistered Persons *[Notification No.1/2019-CGST (Rate), dt. 29-01-2019]*

Notification No. 8/2017 providing exemption up to ₹ 5,000 for RCM u/s. 9(4) and all subsequent amendments to this notification [exempting RCM u/s. 9(4) completely] are rescinded to give effect to amendment to Sec. 9(4) whereby RCM shall be applicable only for specified class of registered person on specified categories of goods and services.

(Similar Notification No. 01/2019-IGST (Rate), dt. 29-1-2019)

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Exemption to job-workers from registration aligned with CGST Rules *[Notification No.2/2019-Integrated Tax, dt 29-1-2019]*

Notification No. 7/2017dt. 14-9-2017 providing exemption from registration to job workers engaged in providing inter-state services relating to jewellery, goldsmiths' and silversmiths' wares and other articles amended to substitute Entry No. 151 with Entry No. 5 in Annexure to Rule 138 to align with CGST Rules.

CIRCULARS

Applicability of GST on various programmes conducted by IIMs *(Circular No. 82/2018-CGST dt. 1-1-2019)*

- On Indian Institute of Management Act, 2018 coming into force on 31-1-2018 all IIM's are "educational institutions" as per Notification No. 12/2017-CGST (Rate) dt. 28-6-2017.
- Accordingly, all long duration programmes (one year or more) provided by IIMs to their students are exempt from levy of GSTw.e.f. 31-1-2018.
- However, short term programs by IIMs for which participation certificates is awarded are not qualification recognised by law and thus liable for GST @18%.
- Prior to 31-1-2018 only 3 programmes of IIMs were covered under Sl. No. 67 of Notification No. 12/2017 dt. 28-6-2017 which were exempt

Applicability of GST on Asian Development Bank (ADB) and International Finance Corporation (IFC) *(Circular No. 83/2018-CGST dt. 1-1-2019)*

- It is clarified that the services provided by IFC and ADB are exempt from levy of GST as per provisions of IFC Act, 1958 and ADB Act.
- The exemption will be available only to the services provided by ADB and IFC. Any entity appointed by or working on behalf of ADB or IFC are not exempt.

Classification of service of printing of pictures *(Circular No. 84/2018-CGST dt. 1-1-2019)*

- It is clarified that the service of "printing of pictures" falls under service code "998386: Photographic and video graphic processing services"and not under "998912: Printing and reproduction services of recorded media, on a fee or contract basis" as per explanatory notesto the scheme of classification of services annexed to Notification No. 11/2017-CGST (Rate) dated 28-6-2017.
- Accordingly, this service of printing of pictures will be taxable @ 18% as per Entry 21(ii) of Notification No. 11/2017-CGST (Rate) dt. 28-6-2017.

Clarification on GST rate applicable on supply of food and beverage services by educational institution *(Circular No. 85/2018-CGST dt. 1-1-2019)*

- It is clarified that supply of food and beverages by educational institution itself to its students, faculty and staff are exempt under Notification No. 12/2017-CGST (Rate), dt. 28-6-2017 *vide* S1.No. 66.
- However, supply by any person other than educational institution based on contractual agreement is leviable to GST @ 5%.

GST on Services of Business Facilitator (BF) or a Business Correspondent (BC) to Banking Company *(Circular No. 86/2018-CGST dt. 1-1-2019)*

- It is clarified that banking company is service provider for BF model or BC

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model operated by a Banking Company as per the RBI guidelines.

- The banking company is liable for GST on entire value of service charge or fee charged to customers whether or not received *via* BF or the BC.
- Services provided by BF / BC to a banking company in rural areas are exempt *vide* entry no. 39 of Notification No. 12/2017, dt 28-6-2017 provided –
  - a) Supply of services fall under head 9971
  - b) Such services are in respect of accounts in a branch located in rural area
  - c) Such branch is classified under rural area as per RBI guidelines

Eligibility of service tax as transitional credit after amendment to Sec. 140 *(Circular No. 87/2018-CGST dt. 1-1-2019)*

- It is clarified that CENVAT credit of service tax paid was available as transitional credit u/s. 140(1) and the legal position has not changed due to amendment of Sec. 140(1) dealing with "eligible duties".
- Accordingly, it is decided not to notify Explanation 1 & 2 to Sec. 140 of CGST Act.

PRESS RELEASE

Decisions taken in 32nd GST Council Meeting to give relief to MSME *[Press Release dt. 10-1-2019]*

1. **Composition scheme:** [applicable w.e.f. 1-4-2019]
   - The limit of annual turnover for availing composition scheme for goods shall be increased to ₹ 1.5 crore.
   - Composition scheme for service providers to be introduced with total GST @ 6% having annual turnover in preceding FY up to ₹ 50 lakh.
   - Only one annual return will be required to be filed by all Composition suppliers. However, payment of taxes would remain quarterly (along with a simple declaration).
2. **Threshold limit for registration by supplier of goods:** [applicable w.e.f. 1-4-2019]
   - Two threshold limits will be given for registration by supplier of goods viz. ₹ 40 lakh and ₹ 20 lakh at the option of States. The threshold for registration for service providers would continue to be ₹ 20 lakh and in case of Special category States ₹ 10 lakh.
3. **Free Accounting and Billing Software** shall be provided to small taxpayers by GSTN.
4. **Matters referred to Group of Ministers:** to boost residential segment of real estate sector and examine GST rate structure on lotteries.
5. **Revenue mobilisation for natural calamities:**
   - Approved levy of cess on intra State supply of goods and services within the State of Kerala at a rate not exceeding 1% for a period not exceeding 2 years.

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THE CENTRAL GOODS AND SERVICES TAX (AMENDMENT) ACT, 2018

Section 2 – Definitions

- Sec. 2(17) – Definition of business:

  Scope of activities of race club provided in clause (h) is widened to include all activities of a race club and activities of a licensed book maker in such club.

- Sec. 2(18) - Definition of business vertical is omitted

- Sec. 2(102) – Definition of services:

  Explanation inserted to clarify that "services" includes facilitation or arranging transactions in securities.

Section 7 – Levy and Collection of tax

Previously due to clause (d), interpretation of Schedule II led to the activities specified therein to constitute as deemed supply. Clause (d) is omitted retrospectively and sub-section (1A) is inserted to provide that activities will constitute supply in accordance with sub-section (1) and Schedule II shall only decide whether a supply is in the nature of supply of goods or supply of services.

Section 9(4) – Levy and Collection

Section 9(4) is amended to provide that liability under Reverse Charge in case of goods and services received from unregistered persons shall be liable only for specified class of registered persons in respect of supply of specified categories of goods or services from unregistered persons.

[Similar amendment is also made to section 5(4) of IGST Act, 2018]

Section 10 – Composition Levy

- Sub-section (1) amended to provide that persons opting for composition scheme are liable to pay tax only on outward supplies covered u/s. 9(1) and not on inward supplies covered under RCM.

- Proviso to sub-section (1) amended to give power to increase limit under composition scheme up to ₹ 1.5 Crores.

- New proviso to sub-section (1) inserted to allow composition dealer to supply services of value up to 10% of turnover or five lakh rupees, whichever is higher

Section 12 & 13 – Time of Supply of Goods & Services

- Sub-section 2(a) amended to withdraw reference of "sub-section (1) of Sec. 31" used to specify time limit for issuing invoice as it was not covering the cases of revised invoice, continuous supply, sale on approval and termination of contract etc. as provided u/s. 31(3) to 31(7) .

Section 16(2) – Input Tax Credit

- Explanation to clause (b) amended to allow ITC also in case of services provided to third party under direction of service receiver.

Section 17 – Apportionment of credit and blocked credits

- Sec. 17(3) provides for value of exempt supply for the purpose of apportionment of ITC. Explanation is inserted to clarify that value of exempt supply shall not include value of activities and transactions specified in schedule III except for sale of land and subject to paragraph 5(b) of Schedule II, sale of building.

- Sec. 17(5) Blocked Credits:

  Clause (a) is amended and clause (aa) and (ab) is inserted: ITC on motor vehicles, vessels & aircraft

  – ITC is restricted only to the extent of motor vehicles for transportation of persons having approved capacity of not more than 13 persons (including the driver) unless used for specified purposes of further supply of the same, use for training, transport of passengers.

– Reference of 'other conveyances' omitted. Hence ITC would now be available in respect of dumpers, work-trucks, fork-lift trucks and other special purpose motor vehicles.

– Separate entry for vessels & aircrafts inserted.

– ITC available to manufacturer on general insurance and repairs & maintenance.

Clause (b): Other ITC

– ITC in respect of food and beverages, health services, renting or hiring of motor vehicles, vessels and aircraft, travel benefits to employees etc., can be availed where the provision of such goods or services is obligatory for an employer to provide to its employees under any law for time being in force.

– ITC on renting or hiring of motor vehicles, vessels or aircraft is allowed when they are used for purposes specified.

Section 20 – Manner of distribution of credit by ISD

Definition of turnover amended to also reduce the amount of tax levied under Entry 92A of List I of the seventh schedule of the Constitution (taxes on sale or purchase of goods in the course of inter-state trade or commerce) from the value of turnover.

Section 22 – Persons liable for registration

- Aggregate turnover limit for registration for Special Category States increased to ₹ 20 lakh subject to conditions and limitations as may be notified.

- For the purpose of this section, along with Jammu & Kashmir, States of Arunachal Pradesh, Assam, Himachal Pradesh, Meghalaya, Sikkim and Uttarakhand are removed from the meaning of "Special Category States."

Section 24 – Compulsory registration in certain cases

- Compulsory registration by electronic commerce operator applicable only if such electronic commerce operator is liable to collect TCS.

Section 25 – Procedure for registration

- Proviso added to provide for a separate registration by a person being developer of SEZ or having unit in SEZ distinct from his place of business outside SEZ within same State or Union Territory.

- Separate registrations can be applied for multiple place of business within same State or Union Territory subject to conditions as may be prescribed. Condition of separate business vertical is omitted.

Section 29 – Cancellation of Registration

- Marginal section heading amended as "Cancellation or Suspension of Registration".

- Proviso added to provide for suspension of registration for such period and in such manner as may be prescribed during pendency of proceedings relating to cancellation. This would relieve compliance burden during pendency of cancellation.

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Section 34 – Credit and debit notes
Sub-section (1) and (3) amended to provide that-

- A consolidated debit or credit note can be issued for more than 1 invoice
- More than one debit or credit note can be issued for one invoice

Section 35 – Accounts and other records
Proviso added to exempt Department of Central Govt., State Govt. or a local authority whose books of account are subject to CAG Audit or an auditor appointed for auditing the accounts of local authorities under any law for time being in force.

Section 39 – Furnishing of returns

- Proviso added to provide for quarterly return filing by person other than ISD for certain class of registered persons.
- Proviso added to sub-section (7) to empower the Government to notify class of persons for making payment of tax on or before the last date on which return is to be filed.
- Sub-section (9) amended to allow rectification of omission or incorrect particulars noticed in any return, in subsequent return in such form and manner as may be prescribed.

Section 43A inserted to provide for new procedure for furnishing return and availing input tax credit
New section is inserted as a step towards 'Simplification of GST Return – Ease of doing business' as new returns are proposed in coming months. The section provides for prescribing the procedure for quarterly filing of return and availing input tax credit.

Section 48 – Amended to expand the scope for GST Practitioners to perform other functions such as filing refund claim, filing application for cancellation etc.

Section 49 (5) – Payment of tax, interest, penalty and other amounts

- Clause (c) and (d) are amended to provide that the credit of SGST/UTGST can be utilised for payment of IGST only when the balance of ITC on account of CGST is not available for payment of IGST.

Section 49A and 49B inserted – Utilisation of input tax credit subject to certain conditions and Order of utilisation of input tax credit
ITC under CGST, SGST or UTGST shall be utilised only after the ITC under IGST has first been utilised fully.

The Govt. has been given power u/s. 49B to prescribe order of utilizsation of ITC.

Section 52(9) – Collection of Tax at Source
Amendment is made to include reference of returns filed under section 37 as well as section 39 also by suppliers.

Section 54 – Refund of tax

- Sub-section (8)(a) amended to exclude refund of tax paid on supplies made to SEZ as the words "zero rated supply" is replaced by "exports"
- Explanation 2(c) amended to allow consideration for export of services to be received in foreign exchange or in Indian Rupees wherever permitted by RBI.
- Explanation 2(e) is substituted to provide that relevant date in case of refund on account of inverted duty structure 'due date of furnishing return for the said period' in which such refund claim arises instead of 'end of financial year'.

Section 79 – Recovery of tax
Section is amended to authorise the department to initiate recovery of tax from any other branch in other State of a person.

Section 107(6)(b) and 112(8)(b) – Predeposit for appeals
Amount of pre-deposit payable for filing of appeal before the Appellate Authority and the Appellate Tribunal has been capped at ₹ 25 Cr. and ₹ 50 Crore respectively.

(Similar amendment is made in IGST Act to cap amount of pre-deposit at ₹ 50 Crore *and ₹ 100* Crore *respectively)*

Section 129 – Seizure of Goods

- Time limit for payment of tax and penalty in case of detention and seizure of goods has been increased from 'seven days' to 'fourteen days'.

Section 140 – Transition provisions with retrospective application from 1-7-2017

- Clarifies that only transitional credit of eligible duties can be carried forward and not all credits. Closing balance of credit pertaining to EC, SHEC or KKC restricted to be transitioned to GST.
- Explanation 3 added to clarify that "eligible duties and taxes" will exclude any cess not specified or any cess collected as additional duty of customs collected under section 3(1) of Customs Tariff Act, 1975.

Section 143(1)(b) – Time limit for return of input/capital goods sent to job-worker
Time limit for return of inputs/ capital goods sent to job worker i.e., one year and 3 years respectively might be further extended for additional one year and two years, as the case may be by the Commissioner on showing sufficient cause.

Schedule I – Import of Services from related persons

- In paragraph 4, import of service from a related person by both taxable and non-taxable person, whether or not made with consideration, shall be deemed to be considered as 'supply' as the word 'taxable person' is substituted for 'person'.

Schedule III – Activities which shall not be treated as supply
Following entries inserted.

7. Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India.

8 (a) Supply of warehoused goods to any person before clearance for home consumption; and

(b) Supply of goods in case of high seas sales basis before clearance for home consumption

THE INTEGRATED GOODS AND SERVICES TAX (AMENDMENT) ACT, 2018

Section 12(8) – Place of supply of service where location of supplier and recipient is in India
The place of supply of services of transportation of goods, including by mail or courier, where such goods are to be transported to a place outside India, the place of supply is to be the destination outside India.

Proviso to Section 13(3) – Place of supply of service where location of supplier or location of recipient is outside India
Place of supply for any services of treatment or process on goods temporarily imported in India and exported after such process to be the location of the recipient outside India.

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CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Rulings by Authority for Advance Ruling

1. The Banking Codes and Standards Board of India – AAR Maharashtra (2018-TIOL-314-AAR-GST)

Facts, Issue involved and Contention of the Applicant

Applicant is a registered society as well as a registered "Public Trust". It was formed in the year 2006 by the Reserve bank of India (RBI) for the purpose of creating awareness and ensuring the compliance of the Codes and Standards for services provided by the banks of India. For the first 5 years, applicant was fully funded by RBI and the applicant started to raise its own corpus fund for its activities from the member banks from 2007 by way of annual subscription fees depending on the Gross Domestic Assets of the member banks.

Annual subscription is collected only to run the day-to-day activities in the interest of consumer protection. Major part of expenditure is spent on creating consumer awareness of their rights and balance is towards overheads and salaries. No service is provided by applicant to member banks. Membership is voluntary.

Annual subscriptions are credited to corpus and capitalised. The entire operations are carried out only through the interest income and corpus is left untouched at present.

Applicant has sought advance ruling in respect of following questions:

i. *Whether the activity of applicant is falling under the definition of "supply", as per Section 7 of the CGST Act, 2017?*

ii. *Whether the contribution made by the member banks to "Corpus Fund" can be considered as "Consideration", as per Section 2(31) of the CGST Act, 2017, when the said is not the "income" of the applicant?*

iii. *Supply is meant to be between 2 persons, whether the Applicant association/Trust and its Members are legally distinct from each other?*

iv. *Whether "Principle of Mutuality" hold well in GST?*

v. *Whether the activity of Applicant is to be termed as "Business" as provided under Section 2(17)(e) of the CGST Act, 2017?*

Applicant contends that activities carried out by it does not fall within the definition of 'Supply' as per Section 7 of the CGST Act, 2017. There has to be **a supply** of goods or services **by a person** and that too for a **consideration** in the course or furtherance of **business**.

Term 'Business' defined u/s. 2(17)(e) of the CGST Act, 2017 reads as under:

(e) Provision by a club, association, society, or any such body(for a subscription or any other consideration) of the facilities or benefits to its members.

The applicant is not providing any facility or benefit to its members. While becoming the member of the applicant, the banks undertake to adhere to the codes of banks commitment to customers and guidelines prescribed by the applicant. This is an obligation on the banks and applicant is not providing for any benefit or facility to them being a member, in any manner.

The applicant further contends that it is squarely covered under 'Principle of Mutuality' principle and not leviable to GST. The 'Principle of Mutuality' is guided by the gospel that *"No man can trade with himself; he cannot make, in what is its true meaning, taxable profit by dealing with himself"*.

Applicant further supported its view with judgment of Supreme Court in case of Bankipur Club Ltd. [1997]. Further it submitted that said principle of mutuality has its relevance in all taxation laws and has universal application. Mere change in taxing statute cannot make change in fundamental concepts.

Jurisdictional officer contended that the essence of this principle of mutuality is present only in situation wherein the group of persons form an association (formal or informal) and pool their surplus income in the associations' common fund, the fund so collected is then used for the benefit of the members when needed.

In the present case, the member banks have not come together pooling their resources to form the **board** (like applicant) to be used for the benefits of the members, there is no compulsion under any enactment for the member banks to become the member of applicant. The member banks may voluntary leave the membership at any time. Thus principle of mutuality is not squarely applicable in present case. Therefore, the applicant is a **"Person"** doing **"Business"** of "Supply" of services for monetary "**Consideration**" received in the form of subscription. Hence, the supply of services by applicant is eligible to GST.

A sum total of analysis of the terms **"Supply"**, **"Consideration" and "Business"** would make it clear that the activity of the applicant falls under aforesaid terms or not.

Discussions by and observations of AAR

Authority observed that activities undertaken by the applicant are only for and in respect of member banks who have voluntarily become their members. Hence, their primary objective is to guide the public and publicise about the codes and standards and commitments of their member banks.

In absence of applicant's codes and standards, all the banks would have been required to formulate their own codes and standards for their services to their customers. Thus it is observed that a very crucial function, which the banks would have been required to perform, is being **performed by the applicant** for their **benefit** in terms of winning confidence of customers about their services.

Secondly, it is to be examined whether **these services are for a consideration or otherwise.** For performing the said activities, the applicant collected funds in the form of annual membership fees and registration fees **("Corpus fund")**. This fund is used to generate interest income which is used for performing their activities. Thus, the consideration is received in form of aforesaid fees.

Further, it was submitted that only those banks who are members will be facilitated and that too for membership fees and annual fees. This is clearly in the form of benefit to member banks as opposed to non-member banks and these services are clearly with a view **to enhance the credibility of their banking services** and therefore to grow their banking business.

The applicant took a stand that their entire activity is squarely covered under the 'Principle of Mutuality' and not leviable to GST. This argument does not hold good for the present facts.

Ruling of AAR

In respect of question (1), activity of applicant qualifies as "**Supply**".

In respect of question (2), contribution made by the member banks will be considered as "**Consideration**".

In respect of question (3), applicant and its members are **legally distinct** from each other.

In respect of question (4), **"Principle of Mutuality"** does not hold good.

In respect of question (5), activity of applicant will be termed as "**Business**" u/s. 2(17)(e) of CGST Act.

2. Crown Beers India Private Limited – AAR Maharashtra (2018-TIOL-303-AAR-GST)

Facts, Issue involved and Contention of the Petitioner

Applicant has entered into a tie-up Agreement ("Agreement") with Privilege Industries Limited (PIL) whereby PIL undertakes brewing/manufacturing, packaging and supply of Beer from its bottling unit to buyers / distributors in the territory identified by the applicant.

In order to manufacture Beer at the bottling unit, PIL undertakes the following activities:

- Purchase the required material (inputs); arrange labour and all other facilities.
- Carry out all processes required for brewing/manufacturing, bottling and packing of Beer.
- Maintain physical stock of beer in the Bottling unit or in warehouses.

PIL will manufacture beer in terms of agreement and in strict compliance with the policies, operating procedures and quality and performance parameters and standards laid down by the applicant.

In consideration for the fulfilment of the abovementioned obligations, PIL shall be entitled to a fixed fee for the products so manufactured.

Applicant has sought Advance Ruling for the following questions:

1. *Whether GST can be levied on the payment of fixed fee and costs received by PIL as a consideration for Brewing/Manufacturing, packing and supply of beer, which is in the nature of alcoholic liquor for human consumption and is excluded from the ambit of GST?*
2. *If the supply of beer is held to be a service by way of job work in relation to beer, what shall be the rate of GST that shall be levied to the said Taxable Supply?*

Applicant drew reference from Article 366(12A) which defines "Goods and Service Tax" to mean tax on supply of goods and services except taxes on supply of alcoholic liquor for human consumption.

Entry 54 of List II to Seventh Schedule of Constitution authorises State Government to levy taxes on supply of alcoholic liquor for human consumption.

CGST/MGST/IGST Act provide for levy and collection of GST on supply of goods or services. However, levy section under all the Acts specifically excludes supply of alcoholic liquor for human consumption.

Applicant has not disputed to the fact that the transaction of PIL falls under the scope of supply and is in course or furtherance of its business. However, applicant humbly states that the supply made by PIL is of alcoholic liquor for human consumption. Such supply is excluded from the purview of taxability at the threshold itself.

Applicant also submitted that PIL is not working on another person's goods. PIL purchases required material on its own, then manufactures, and packs the beer out of such goods. It cannot be said as "any treatment or process which is applied to another person's goods" and thereby cannot be deemed as a service under GST legislation.

Discussions by and observations of AAR

Applicant pays various costs to PIL as a consideration for purchasing the required raw materials, arranging labour and all other facilities. As per the agreement applicant would pay to PIL such costs for purchasing the goods mentioned above and therefore they are effectively their own goods.

In respect of the 'costs' paid and received by the two parties, there is no supply of goods or services in the form of sale, transfer, barter, exchange, etc., and therefore there is no requirement to pay GST on such costs paid by the applicant to PIL.

However, in respect of fixed costs paid by applicant to PIL, it is very clear that the fixed costs are paid to PIL because they are providing job work services to the applicant. In this matter of payment of fixed costs there is a supply of service by PIL to applicant in form of brewing / manufacturing, packaging and supplying of beer. For these services rendered there is a consideration which flows from the applicant to PIL in form of fixed costs.

Entire services rendered by PIL and consideration paid by applicant is in course or furtherance of business of both. Hence this amount is liable to tax under GST laws and tax is payable by supplier i.e., PIL.

In respect of second question, AAR was of the view that supply of beer as such is not a service. Service in this case is the entire gamut of brewing/manufacturing, packaging and supplying beer by PIL to the applicant for which PIL receives fixed costs as job work charges.

If the applicant had brewed/manufactured, packaged and supplied beer on their own then their activity would not have been liable to tax under the GST Laws since supply of alcoholic liquor for human consumption is out of the ambit of GST laws. It is very clear that it is a job work service provided by PIL, which is to be taxed under GST.

Ruling of AAR

In respect of question (1), taxes have to be discharged by PIL on fixed fee received and not on costs received.

In respect of question (2), supply of beer *per se* is not taxable under GST. What is taxable in subject case is the job work which is service provided by PIL to the applicant, for which they are receiving the consideration.

3. M/s. Cable Corporation of India Limited – AAR Maharashtra (2018-TIOL-302-AAR-GST)

Facts, Issue involved and Contention of the Petitioner

Applicant is a leading manufacturer and distributor of a wide range of power and control cables in India. Applicant is engaged in the work of Supply, Laying and Terminating of 220kV U/G cables package. The engagement comprises of two separate agreements with respect to the supply of goods and services envisaged, which are as follows:

- A supply of goods contract regarding the engineering, manufacturing, supply and type testing of Cable Package-C ('Goods')

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- A Services Contract for Cable Package-C (it includes Route Survey, Planning, **Transportation**, etc., required for complete execution of Cable Package-C) ("Services")

Both contracts contain a "Cross Fall Breach Clause" according to which any breach in either of the contracts would be a breach of the other contract as well and would provide the recipient with an absolute right to terminate both the contracts or claim damages. The aforesaid supplies of both contracts have separate consideration. One of such supplies is that of transportation with separate consideration.

Applicant seeks ruling as to whether the supply of transportation services, rendered by the applicant, will be exempt from the levy of GST in terms of Sl. No. 18 of the Notification No. 12/2017 - Central Tax (Rate) dated 28th June, 2017.

Entry 18 of Notification No. 12/2017 – Central tax (rate) **exempts** *services by way of transportation of goods by road except the services of GTA / courier agency.*

Applicant submits that it is hiring services of GTA to provide aforesaid transportation services but itself is not a GTA, and therefore, is eligible to claim exemption under Sl. No. 18.

Applicant further states that above goods and services are not covered under definition of "Composite Supply" u/s. 2(30) of CGST Act which reads as under:

"composite supply" means a supply made by a taxable person to a recipient consisting 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 the ordinary course of business, ***one of which is a principal supply;***

Since in case of applicant's case, there is more than one principal supply [defined u/s. 2(90)], therefore, aforesaid supplies of goods or services cannot be covered under definition of Composite Supply. Applicant stated that the fact that contract envisages different consideration for each supply, it is indicative of parties intention to treat each of them separate and independent. Even though contract stipulates single consideration for transportation and insurance services, the applicant is majorly charging for transportation services.

Discussions by and observations of AAR

Applicant is not transporting the goods but hiring services of GTA to undertake transportation of goods and is discharging GST liability under reverse charge mechanism. Therefore, he is a recipient of service, not the supplier thereof.

Further, the first contract includes ex-works supply of all equipment & materials. The scope of the works include testing and supply of cable package required for successful commissioning.

The second contract includes all other activities required to be performed for complete execution of the cable package. The scope of the work includes transportation, insurance and other incidental services. It is apparent that the first contract has 'no leg' unless supported by the second contract. The contractee is aware of such interdependence of the two contracts. It is abundantly clear that notwithstanding the breakup of the contract price, the contract shall, at all times, be construed as a single source responsibility and the applicant shall remain responsible to ensure execution of both the contract to achieve successful completion. Any breach in any part of first contract will be treated as breach of second contract and *vice versa*.

The two contracts are, therefore, linked by a cross fall breach clause deeming that any breach in either of the contracts to be a breach of the other contract as well, providing the recipient with an absolute right to terminate both the contracts or claim damages. The "cross fall breach clause" settles unambiguously that

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supply of goods, their transportation to the contractee's site delivery and related services are not separate contracts, but only form part of an indivisible composite works contract supply, as defined under Section 2(119) of the GST Act, with 'single source responsibility.

Composite nature of the contract is clear from the facts that first Contract cannot be performed satisfactorily unless the goods have been transported and delivered to the contractee's site.

Both these contracts consisting of cross fall breach provisions are in the nature of 'Composite supply of Works Contract' which is a service and would be taxable @ 18% in terms of Sr. No. 3(11) of Notification No. 11/ 2017 — Central tax (Rate) dated 28-6-2017 and artificial bifurcation of contracts & scope of work is not legal and proper.

Ruling of AAR

In view of above, the exemption will not be available to applicant for transportation services. The first and second contracts referred above are in the nature of 'Composite supply of Works Contract which is a service and would be taxable @ 18%.

4. Lear Automotive India Pvt. Ltd.– AAR Maharashtra (2018-TIOL-306-AAR-GST)

Facts, Issue involved and Contention of the Petitioner

Applicant is engaged in the manufacture of automotive seats, which is manufactured in its various plants located in Maharashtra. The present case is filed in respect of valuation of supply of automotive parts (final goods), which are manufactured **out of tools received from the customers on Free of Cost (FOC) basis**.

Applicant manufactures automotive seats for various customers such as Ford Motor Private Limited, Volkswagen India Private Limited, Mahindra and Mahindra Limited, etc., by using tools / moulds either provided or owned by them (customers).

Generally, the applicant gets the tools from the third party as per the requirements of the customers. The property of the tools is transferred to the applicant and eventually to the customer. However, the possession remains with the applicant to use the same to manufacture the products as per the requirements.

Applicant has sought advance ruling as to *whether the amortised value of the tool received on FOC basis from the customer is required to be included in the value of finished goods manufactured and supplied by the applicant to the customer?*

In terms of section 15(2)(b) of the Act, if any amount which the supplier is liable to pay but the same has been incurred by receiver of the supply, then the said amount has to be added while determining the transaction value. Thus, it is a matter of commercial arrangement between parties as to what is in the scope of both the parties. Once it is clear that a particular activity is in the scope of receiver of supply, then there is no question of adding the value of the same in determining the transaction value.

The only question, which requires examination, is whether the price paid by customers is sole consideration for the supply of parts made by applicant. In this regard, providing the tool which is in the domain of receiver of the supply as per the terms of contract cannot be said to be non-monetary consideration provided by the receiver of the supply to the provider of supply since upon paying the tool development charges, customers are not incurring any expenses, which the applicant was liable to incur. Ownership of the tool remains with the customers and development of tools was always meant to be borne by the customers.

Applicant also relied on Circular 47/21/2018 – GST dated 8-6-2018 issued by CBIC which clarified that value of moulds, jigs, etc. shall not be factored or amortised in value of supply in a situation where the contract stipulates that recipient shall supply moulds, jigs, etc.

Discussions by and observations of AAR

Issue to be decided in present proceeding is whether the goods which are claimed to be supplied FOC would form part of value of taxable supply.

Several representations were received by CBEC seeking clarification on issue 'whether moulds and dies owned by the Original Equipment Manufacturer (OEM) that are sent FOC to Component Manufacturer (CM) is leviable to tax and whether OEM's are required to reverse ITC?

CBEC *vide* its circular 47/21/2018 – GST dated 8-6-2018 clarified that goods owned by OEM that are provided to CM on FOC basis does not constitute a supply as there is no consideration. Value of goods provided on FOC basis will not be added to the value of supply of components. However case is different if contractual obligation to provide the tools is cast on CM but the same is supplied by OEM and in such case, amortised cost of tools need to be added to the value of supply of component.

AAR scrutinised various purchase order's and agreements entered into by the applicant with the customers. On scrutiny of various agreements, AAR was of the view that customer is liable to pay applicant the tool cost for development and manufacture of tooling. It is clearly indicated that the tools procured by the applicant from third party vendor are ultimately supplied to customers for which tax invoice is raised and applicable GST has been charged. Thus the absolute ownership of tools get transferred to OEM. However physical possession of the tool remains with the applicant during manufacturing process.

Tools which are supplied by applicant to customers on payment of GST and which are further supplied by customers to applicant for use in process of the manufacture clearly indicate that supply of tool is of goods owned by customers which is on FOC basis and the transaction is not covered u/s. 15(2)(b).

Ruling of AAR

In respect of question on which ruling is sought, the amortised value of the tool received on FOC basis from the customer is not to be included in the value of final goods.

5. Merck Life Science Private Limited – AAR Maharashtra (2018-TIOL-308-AAR-GST)

Facts, Issue involved and Contention of the Petitioner

Applicant has entered into a Business Transfer Agreement dated 21st June 2018 with Merck Limited (seller) wherein the seller has agreed to sell, transfer, convey, assign and deliver to the applicant or to any affiliates as directed by applicant for the BPL business (constituting of BP business, LS business and PM business) which would be transferred as a **slump sale on going concern basis**.

Pursuant to the above, seller, **on the direction of the applicant,** entered into an agreement with:

- Merck Specialties Private Limited (MSPL) for transferring its BP business;
- Merck Performance Materials Private Limited (MPMPL) for transferring its PM business; and
- Applicant for transferring its LS business.

Applicant has sought advance ruling for the following questions:

i. *Whether applicant's direction to the seller (directed in agreement dated 21st June 2018) for direct transfer of BP business to MSPL and PM business to MPMPL, respectively would qualify as a 'supply between the applicant' and 'MSPL/MPMPL'?*

ii. *If the above question is 'affirmative' then as the parties are related, even in absence of the actual consideration does the applicant have to attribute a notional consideration and charge GST in line with Schedule 1 of GST Act to be compliant?*

iii. *If the answer to both the questions are 'affirmative' then as the recipients (MSPL/ MPMPL) are eligible to avail full input tax credit (ITC) then the notional consideration (percentage of the business transfer value) would be only academic and will the invoice value be considered as open market value?*

Applicant's understanding was as under:

- Applicant has only directed the seller to sell its BP and PM business to MSPL and MPMPL respectively.
- There is no separate activity flowing between applicant and MSPL / MPMPL.
- Consideration would be received by seller directly from MSPL / MPMPL.
- There would be no separate consideration flowing from MSPL / MPMPL to the applicant.
- Applicant does not qualify as intermediary under the instant case
- Transaction is not in course or furtherance of business
- Transaction will also not qualify under Schedule II
- Transaction is revenue neutral in hands of the government.

Even if above transaction was considered to be taxable, then open market value should be the value declared in invoice. Further as the transaction would be used or intended to be used in course or furtherance of business by MSPL and MPMPL, both the parties are eligible to claim ITC of GST charged by applicant.

Discussions by and observations of AAR

In respect of the agreements entered into, the applicant has only directed the seller to transfer BP business and PM business as going concern on slump sale basis to the affiliates i.e. MSPL and MPMPL.

In order to ascertain whether direction given by the applicant qualifies as a supply between the applicant and MSPL/MPMPL, AAR referred to the scope of supply, Schedule I and Schedule II of CGST Act.

Act of direction on part of applicant needs to be examined in respect of it being service under para 5(e) of Schedule II which reads as:

"(e) Agreeing to the obligation to refrain from an act or to tolerate an act or a situation or to do an act."

AAR examined the terms of various agreement (entered into between the applicant and seller and the affiliates) in order to ascertain whether the act of giving direction by the applicant would fall in the scope of supply. It was of the view that:

- Role of applicant is very crucial in respect of various agreements entered into.
- Without the directions of the applicant, the agreement between seller and affiliates could not have materialised.
- Applicant is an active party to all the agreements and its directors have active role in all aspects of the agreement.

Role of applicant is clearly a service covered in para 5(e) of Schedule II wherein the applicant is doing the act of giving direction to the seller for transfer of its businesses to the affiliates. The transfer of business as well as the terms and conditions thereof are as per the direction of the applicant.

Sale and purchase could only have been taken place because of the applicant and thus the act of direction is very crucial and further sale to affiliates cannot take place without the direction

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of the applicant. The applicant is the central pillar of the slump sale.

Since it is provision of service between related persons, value needs to be determined in accordance with Rule 28 of CGST Rules.

Ruling of AAR

In respect of the questions (1), the direction provided by the applicant would qualify as supply between 'the applicant' and 'MSPL/ MPMPL'.

In respect of question (2) and (3), the value would be determined as per Rule 28 of CGST Act, 2017.

6. M/s. Sir J. J. College of Architecture Consultancy Cell (2018-TIOL-313-AAR-GST)

Facts, Issue involved and Contention of the Petitioner

Applicant is consultancy cell formed as per the guidelines of the Council of Architecture which is a statutory body under the Act of Parliament and University of Mumbai. Government of Maharashtra has permitted the applicant to render services of Architecture. Applicant provides services only to Government bodies, State corporations and PSUs in relation of comprehensive architecture services which include project design, structural design, MEP design, drawings, study reports, etc.

Applicant has entered into an agreement with Municipal Corporation of Greater Mumbai (MCGM) for an upcoming project of establishment and development of a Textile Museum in Mumbai. Applicant will provide comprehensive architecture services and project management services, which include project design, structural design, MEP design, drawing, study reports, reviewing tender document for inviting contractors, site supervision and certifying bills of contractors paid by MCGM.

As per Notification No. TPB 4312/789/CR-27/2013/UD-11 of urban land department, the textile museum is treated as part of recreational ground area and ancillary facilities of recreation like exhibition, fashion show, cafeteria, etc. have been allowed to be developed in the said area.

Applicant seeks ruling as to whether it is liable to charge GST on the ***consultancy services*** *rendered to MCGM for an upcoming project of establishment and development of textile museum in Mumbai.*

Above question relates to applicability of Sl. No. 3 of Notification No. 12/2017-Central Tax(Rate) which exempts - ***"Pure services (excluding works contract service*** *or other composite supplies involving supply of any goods) provided to Central Government, State Government or Union Territory or local authority or a governmental authority by way of any activity* ***in relation to any function entrusted*** *to a panchayat under* ***Article 243G*** *of the Constitution or in relation to any function entrusted to a Municipality under* ***Article 243G*** *of the Constitution."*

Applicant submits that agreement entered with MCGM has been registered after payment of stamp duty with State Government under Article 63/63 as works contract agreement as advised by MCGM. Further, establishment of museum and recreation ground is not considered as function entrusted under aforesaid Articles of Constitution, therefore, GST is chargeable.

Discussions by and Observations of AAR

Applicant provides comprehensive architecture services to MCGM. It involves heritage restoration and adoptive use of various structures such as textile museum, library building, back office support for staff, underground public parking, etc.

Agreement entered into by applicant and MCGM has been registered after payment of stamp duty with State Government under articles 63/63 as works contract agreement.

Applicant in its application have stated that establishment and development of museum and recreation ground is not considered as a function listed in 12th schedule to be read with Article 243W of Constitution.

Applicant has not provided detailed copy of contract entered into with MCGM which would in detail give exact nature of activities being done by them and which would be very crucial in deciding whether the services provided by applicant are in nature of pure services or works contract services.

Jurisdictional officer has submitted copy of receipt of stamp duty paid for registration of contract wherein the contract is clearly shown to be works contract. Further, the applicant also stated in their submissions that agreement is registered as works contract agreement.

Thus services provided by applicant are in nature of works contract services and not eligible for exemption.

Ruling of AAR

In respect of question raised by the applicant, GST is leviable on consultancy services rendered to MCGM for an upcoming project of establishment and development of textile museum in Mumbai.

7. M/s. GGL Hotel and Resort Company Ltd. – AAR West Bengal (2019-TIOL-07-AAR-GST)

Facts, Issue involved and Contention of the Applicant

Applicant is engaged in the hospitality and real estate business and is contemplating a new project (construction of resort) on a leasehold land acquired from Bengal Housing Infrastructure Development. The project is proposed to be completed within a period of two years from the date of foundation of the project. The applicant shall capitalise lease rent paid during the pre-operative period in the books of account.

Applicant seeks ruling as to *whether ITC is available for lease rent paid during pre-operative period for the leasehold land on which the resort is being constructed to be used for furtherance of business, when the same is capitalised and treated as capital expenditure.*

The concerned officer submits that credit of tax paid on goods and services used for construction of immovable property is allowed only if such immovable property is in the nature of plant and machinery. The expression plant and machinery has been defined *vide* explanation to section 17 to mean apparatus, equipment , and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services and includes such foundation and structural supports but excludes *inter alia* land, building, or any other civil structures. The input tax credit is, therefore, not admissible for the lease rent paid during the pre-operative period for the leasehold land on which a resort is being constructed.

Applicant submitted that it is eligible to avail ITC in respect of lease rent paid for leasehold land in terms of Section 16(1). Further, Section 17 of the CGST Act deals with apportionment of credit and blocked credit. Sub-section 5(d) of the said Section reads as under:

(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.

The expression "construction" is explained to include reconstruction, renovation, additions, alterations, or repairs, to the extent of capitalisation, to the said immovable property. GST Act does not define the exact nature of goods or services received that are deemed to relate to construction of immovable property, therefore, meaning in common parlance is to be considered.

The lease rent for the pre-operative period is capitalised under the head 'Leasehold Land' and not under the head 'Building Block'. Therefore, it can be inferred that the lease rent is not used for construction of the resort. Hence, the renting services cannot be said to be received for the construction of immovable property as there is no nexus, direct or indirect, between the construction of the hotel and banquet and the rental service availed. Further, mere capitalisation of the lease rental cannot make such services as received for the construction of immovable property.

Discussion by and observation of AAR

The moot question is whether the lease rental paid during the pre-operative period should be treated as part of the cost of goods and services received for the purpose of constructing an immovable property (other than plant and machinery) on the applicant's own account.

Para 23 of Accounting Standard 10 is relevant. It says that the cost of a self-constructed asset should be determined using the same principles as for an acquired asset, and it is usually the same as the cost of constructing an asset for sale. When an immovable property like a building is sold, the profit is computed by deducting the cost of the property, including the land, from the sale proceeds. The cost of constructing the immovable asset, therefore, includes the lease rental paid for right to use the land on which the asset is to be built.

Construction of the hotel etc., is impossible unless the applicant enjoys uninterrupted right to use the land. It is clear from the agreement that applicant cannot enjoy that right if he fails to pay the lease rental. Construction of the immovable property is, therefore, critically dependent on the supply of the leasing service. The nexus between them is, therefore, direct and the two are inseparable. The leasing service for right to use the land is, therefore, a supply for construction of the immovable property.

The prohibition from availing input tax credit, as provided under section 17(5)(d) of the GST Act extends to the immovable property in general (other than plant and machinery), which includes the supplies received for retaining the right to use and develop the land. Such supplies are essential for construction of the civil structure on the piece of land.

The applicant will admittedly capitalise the lease premium. The property is, therefore, admittedly being constructed on the applicant's own account and treated as fixed asset, including the lease rental paid. Whether the lease rental paid for the pre-operative period is capitalised under the head 'Leasehold Land' or 'Building Block' is of little significance in this context.

Ruling by AAR

Input Tax Credit is not available to the applicant for lease rent paid during pre-operative period for the leasehold land on which the resort is being constructed on his own account, when the same is being capitalised and treated as capital expenditure.

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What is the use of living a day or two more in this transitory world? It is better to wear out than to rust out – specially for the sake of doing the least good to others.

— *Swami Vivekananda*

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Service Tax – Case Law Update

Citation: 2019 – TIOL – 286 – CESTAT – Bangalore

Case: M/s. Dell International Services India Pvt. Ltd. vs. CCT, Bangalore

Background Facts of the case

In the matter of appeal filed, the Registry objected that the appellant had not paid/ submitted the proof of 7.5% of the duty/tax paid while filing the appeal u/s. 35F of the CEA, 1944.

Arguments put forth

The Appellants submitted as under:

a) They had already reversed 7.5% of the duty demanded through CGST credit / electronic credit ledger and the same has been indicated in column 4B (2) of GSTR-3B filed for the month of August 2018.

b) This payment is permissible in view of Circular No. 58/32/2018 – GST dated 4-9-2018 and also Circular No. 42/16/2018 –GST dated 13-4-2018, therefore the objection raised by Registry is not tenable in law.

c) The Board *vide* Circular No. 42/16/2018-GST dated 13th April, 2018, has clarified that the recovery of arrears arising under the existing law shall be made as central tax liability to be paid through the utilisation of the amount available in the electronic credit ledger or electronic cash ledger of the registered person, and the same shall be recorded in Part II of the Electronic Liability Register (FORM GST PMT-01).

Decision

a) After considering the submission made by the learned counsel, it is inferred that the appellant has reversed the 7.5% of the duty demanded through the CGST credit ledger and the same is indicated in the column 4B(2) of the GSTR-3B filed for the month of August 2018. The AR also accepted the position that the mandatory pre-deposit can be made through the CGST credit.

b) Registry to admit the appeal on record and list the same for final disposal in due course. Accordingly, the appeal filed by the assessee was allowed.

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Citation: 2019-TIOL- 215 – HC – DEL-ST

Case: M/s. Meinhardt Singapore Pte. Ltd. vs. CST, Delhi

Background facts of the case

The appellant was a regular service tax assessee. However, they had not paid the entire service tax liability for period starting from 2006-07, 2007-08 to 2008-09 (April to September) & discharged only a part thereof belatedly. It was claimed that they were not able to discharge the liabilities due to some internal difficulties. Further, the amounts were not available with it during the relevant time. Show cause notice was issued for levy of the penalty for late payment of service tax. The ground of suppression of material facts too was alleged.

The appellant contested the show cause notice and suffered adjudication imposing penalty of 100% u/s. 73(4) read with section 78 of the Finance Act, 1944. Hence the present appeal.

Arguments put forth

The appellants submitted as under:

a) Certain amounts of service tax was paid by the assessee in normal course which was also taken into account while imposing penalty

b) They also pleaded for reduction of penalty to 25% as service tax and interest was paid before the SCN.

Decision

a) The appellants have contested only the penalty u/s. 78. Thus, the liability to pay the tax is affirmed and there is no dispute over the same. The liability is required to be discharged as soon as the money is received from the client. In the aforementioned case, the assessee has received the amounts against the invoices inclusive of service tax and has not deposited the same with the Government due to financial hardships.

b) The *bona fideness* of the appellant cannot be accepted in such an act as financial hardship cannot be pleaded against penal action when the tax is collected but not deposited with the Government.

c) In this case, it was also noted that in the guise of getting Central registration in Delhi they have given an impression to the service tax authorities in Ranchi that tax is being discharged in Delhi. After numerous follow ups it was noted that the assessee was registered in Delhi only post 15-2-2008. The said order was also affirmed by the decision of the Supreme Court reported in 2016 in the case *(44) S.T.R. J59 (SC)*. In, *IWI Cryogenic Vaporization Systems India vs. CCE, CST, Vadodara – II* reported in 2015–TIOL–1458–CESTAT–AHM, the Tribunal held that when the tax was recovered and not paid to the Department, it is clearly a case of evasion of tax with intention.

d) In the present case also, we note that the appellant did not file statutory returns indicating the provision of service and receipt of taxable income and accordingly we are in agreement with the lower Authority regarding imposition of penalty on the appellant.

e) In other words, when there is a non-payment of service tax within the stipulated time, the authorities are right in proceeding against the appellant to confirm and recover the non-paid tax liability and to impose penalty. We note that the closure of proceeding as pleaded by the appellant in terms of Section 73(3) is not possible in the present case in view of the facts discussed above. Such closure is not permissible if the case is covered under the provisions of Section 73(4).

f) Whatever be the constraint the assessee was faced with, it was duty bound to remit amounts collected by it towards service tax, in a planned manner, and as required by law. The deposit belatedly, by it, on the ground that the amounts were deposited on *ad hoc* basis due to operation of a centralized system, cannot be a legitimate excuse. What is evident is that the assessee withheld the amounts collected from the service recipient as tax liability. As the remitter, assessee it was duty bound to comply with the terms of the Finance Act and Rules, which prescribed not only filing of returns but also periodic deposit of these amounts. The delay in deposit of these amounts spanned over a period of two and half years and therefore, amounted to mis-reporting of true and correct facts. To that extent, the SCN was justified. The finding of misreporting too was warranted.

g) As far as the penalty goes, the provision under Section 78 of the Act, and also even Section 73(4), leave no manner of choice; it is a matter of course. Only mitigating circumstances whereby the penalty could be reduced might have been if the assessee had deposited the reduced amounts (of penalty) within 15 or 30 days of receipt of the SCN as indicated in provisos 1 and 2 to Section 78. Since the reduced penalty amounts were not deposited by the assessee, which is a statutory mandate within the time stipulated by law.

The appeal is accordingly dismissed.

Citation: 2019-TIOL – 230 – CESTAT – Bang.

Case: Kishore Kumar Company Pvt. Ltd. vs. CCE, ST, Bangalore

Background facts of the case

The appellant, M/s. Kishore Kumar & Co. (Exports) Pvt. Ltd., are acting as purchase agents, for overseas buyers of processed sea foods, looking after sourcing the seller, negotiating price on behalf of foreign buyer, checking the quality of the processed food and supervision of the packing and dispatch. They received commission as a percentage of purchase. The principal takes a decision and places order and the appellants who in time place the purchase order on respective Indian exporters. The foreign principal opens a LC in the name of appellant. The appellants then transfer the LC to the exporter with an instruction to the Banker and the exporters that the amount of LC includes the commission of the appellant. After export, the exporter transfers the commission to the appellants in INR. In some cases, the foreign buyer remits the commission to appellants in freely convertible foreign exchange. The Department on the basis of intelligence gathered issued a SCN dated 24-9-2004 covering period 9-7-2004 to March 2007 on the allegations that the appellants provided services falling under Business Auxiliary Service and that the consideration received by them was not in convertible foreign exchange and thus, are not exempted from payment of service tax. Thereafter, 9 periodical Show Cause Notices, covering a period up to March 2014, were issued.

Arguments put forth

The appellants submitted the following arguments:

a) There is no dispute that the services rendered by them are classifiable as 'Commission Agent Services' under the heading 'Business Auxiliary Services', taxable w.e.f. 10-7-2004.

   (i) Counsel submitted that for period from 9-7-2004 to 14-3-2005, as per Notification No. 21/2003 exemption was available if the payment is received in India in CFE; however, there was no condition that such receipt of CFE has to be by the service provider himself.

(ii) During the period from 15-3-2005 to 7-6-2005, in terms of Rule 3(3) of ESR Rules, 2005, the condition that receipt in CFE was made applicable only when the service recipient had office or establishment in India.

(iii) During the period from 7-6-2005 to 18-4-2006, 'such taxable services' provided and used in or in relation to commerce or industry and the recipient of such services are located outside India were exempt.

(iv) For the period 19-4-2006 to 28-2-2007 in terms of Rule 3(2) of ESR Rules, 2005, the conditions required to be fulfilled were:

- Such service is delivered outside India and used outside India and
- Payment for such service provided outside India is received by the service provider in convertible foreign exchange.

(v) For the period 1-3-2007 to 28-2-2008 in terms of Rule 3(2), the conditions required to be fulfilled were:

- Such service is provided from India and used outside India and
- Payment for such is received by the service provider in convertible foreign exchange.

(vi) For the period 1-3-2008 to 26-2-2010, the only condition required to be fulfilled was that the payment for such is received by the service provider in convertible foreign exchange.

(vii) For the period 1-7-2012 till 30-9-2014, the services of appellants were termed as intermediary services and as per Rule 3, the place of supply of services for intermediary services was defined to be the location of the recipient of services.

b) CBEC *vide* circular F.No.B1/4/2006-TRU dated 19-4-2006 has clarified at Para 4.3.5 that 'services specified under Rule 3(1)(iii) (under which the appellant's service falls) were exempt when provided in relation to business or commerce, should be provided to a recipient of service who is located outside India.'

c) He submitted that overall during the period of dispute, the three conditions that required to be satisfied were:

(1) The recipient of service should be located outside India.

(2) The services were delivered outside India and used outside India and

(3) The consideration for services is received in convertible foreign exchange.

d) He submitted that they have complied with all the above conditions.

e) Revenue raised a dispute that the condition regarding receipt of consideration in CFE has not been fulfilled. He submitted that the condition is fulfilled as the foreign exchange has been received and realised through the Indian exporters and was transferred to the appellants. The Hon'ble Supreme Court and the Tribunal in many decisions have held that even if consideration is received not directly but realised through other persons, the same qualifies for exemption under exports.

f) He submitted that the appellant got themselves registered in 2004 itself and *vide* letter dated 3-12-2004 itself informed the Department that their services qualified as export and that they are not collecting and remitting the tax. It was also informed that the consideration would be received through Indian exporter. In view of the above, it is very clear that the Department was well aware of the appellant's business service. The extended period cannot be invoked and penalty cannot be imposed.

Decision

a) In relation to export of services, it is undisputed that the appellant is situated in the taxable territory and the recipient is located outside India. Therefore, it is evident that the service provided by the appellants is either provided to a person located outside India or the benefit of service accrued to a person placed outside India or it could be construed to be provided at a place outside India as the nature of Service Tax was held to be consumption-based destination Tax.

b) In an identical case of M/s. Paul Merchants Ltd., laying down that the services provided by the agents and some agencies being delivery of money to the intended beneficiary of the customer of the western units abroad, which may be located in India and the services provided being business auxiliary services is also to the western unit who is recipient of services and consumers of services, it has to be held that services were being exported in terms of Export of Services Rules, 2005 and not liable to service tax.

c) In view of the above, it is very clear that the services were rendered by the appellant who is located in India and the beneficiary of the services was located outside India and such services were required to be treated as export of services for a harmonious construction of the legal provisions over the years.

Citation: 2019-VIL-65-CESTAT-DEL-ST

Case: Diaspark Infotech Private Limited vs. CGST, CC & CE, Indore

Background facts of the case

The facts of the case are that the appellants are exporters of services. Since they were entitled for availing CENVAT credit, they applied for refund of unutilised CENVAT Credit. However, show cause notice was issued to reject the refund for the reason that the details of the CENVAT Credit were not appearing in the ST-3 Return and no concrete evidence was submitted with the claim that CENVAT credit is available to them.

Arguments put forth

The appellants submitted as under:

a) The only ground for rejection of the claim, as is apparent from order in appeal is the alleged non-fulfilment of condition (g) of the Notification No. 27/2012 dated 18-6-2012 which requires that the amount of refund claim shall not be more than the amount lying in balance at the end of quarter for which refund claim is being made or at the time of filing of the refund claim, whichever is less.

b) It is submitted that though inadvertently in the impugned ST-3, the balance was shown 'Nil'. But it was highly inappropriate on the part of the adjudicating authorities below to ignore the relevant documents as were submitted by the appellant to show the existing balance in accordance whereof the impugned refund was filed.

c) It was also submitted that while replying to the show cause notice itself, a Certificate from the Chartered Accountant certifying the claim of accumulated CENVAT credit was furnished.

The Respondents submitted as under:

a) It was submitted that only document to check the balance available with the assessee at the end of quarter is the ST-3 return filed by the assessee. Since the assessee /appellant herein admittedly had filed the ST-3 return showing 'Nil' balance, the Commissioner (Appeals) has rightly formed an opinion about non-fulfilment of conditions of Notification No. 27/2012.

b) It is submitted that though the appellant herein requested to the Range Superintendant about filing a revised ST-3 return but as per the statutory provision, the return can be modified only within a period of 90 days that too electronically.

Decision

The bare perusal of the condition in the notification makes it clear that what is to be determined to ascertain the eligibility of refund, is the balance of credit lying with the assessee, as on the last date of quarter as well as on the date of filing of the refund. To check the balance lying with the assessee the relevant documents are the accounts of the assessee in the form of balance sheets, bills & invoices. Though whatever balance is being shown in the accounts of the assessee has to find mention in the ST-3 but due to the said documents being the basis of ST-3 as far as the amounts shown therein as balance is concerned, it was opined that ST-3 cannot be the only reliable record to verify the balance CENVAT credit at the end of the quarter, as is held by the adjudicating authority below.

Accordingly the appeal filed by the assessee was allowed and the CENVAT Credit was allowed.

Citation: 2019-VIL-48-CESTAT-HYD-ST

Case: Ericsson India Private Limited vs. CCCE & ST, Hyderabad – II

Background facts of the case

The appellants are operating through a branch office in Secunderabad and corporate office in Gurgaon. Both the offices are registered separately and file ST-3 returns to their corresponding Commissionerates. The corporate office at Gurgaon is engaged both in providing services as well as in supply of equipment trading. The corporate office is also registered as Input Service Distributors (ISD) and distributes credit which they receive among their branch offices and locations across the country including the appellant herein. The branch office is not engaged in trading activity and is only providing taxable services. They take credit of the input services which they receive as well as the credit distributed by their corporate office as ISD. A show cause notice was issued alleging that the credit availed by them in respect of ISD invoices, pertain to trading activities and accordingly not eligible in terms of Rule 6 of CENVAT Credit Rules, 2004.

Arguments put forth

The assessee as appellant submitted as under:

a) The credit distributed by the ISD cannot be questioned at the branch level as has been held by the Tribunal in the case of *Godfrey Philips India Pvt. Ltd. [2009 (239) ELT 323 (Tri-Ahmd.)] - 2009-VIL-02-CESTAT-AHM-ST.*

b) A corporate office is registered under various services and is also engaged in trading activity but there is no exempted service provided in the branch office in Secunderabad. The entire demand was on the basis of audit objection which, if any, should have been taken up with the corporate office.

c) The major portion of the demand is time barred as the relevant period is April, 2005 to March, 2008 while the show cause notice was issued on 6-2-2009. There has been no suppression of facts on the part of the appellant as all relevant information has been furnished in their returns as required under the law. The entire issue involves a *bona fide* interpretation of law and they should not be penalised on this account.

The Respondent submitted as under:

a) The appellant and their corporate office are essentially the same entity, although, registered as two different registrants under service tax and therefore, they should have knowledge of the credit transferred by their head office as ISD.

b) It was further asserted that in terms of Rules 9(5) and 9(6) of CCR, 2004 "the burden of proof regarding the admissibility of the CENVAT credit shall lie upon the manufacturer or provider of output service taking such credit". In this case, it is incumbent upon the appellant to have ensured that the credit was taken especially so when the credit was approved by their own corporate office. Therefore, the demand as well as the penalty is sustainable.

Decision

a) There is nothing in the allegations that show that the appellant (Ericsson India Pvt. Ltd., Secunderabad) registered as service tax payer in their Secunderabad office had taken any credit wrongly. They have not rendered any exempted services and were therefore, not required to reverse any CENVAT credit.

b) The allegation in the show cause notice is that the corporate office, which is a separate registrant and also as an ISD (although part of the same corporation) which is registered in Gurgaon (Haryana) had wrongly taken CENVAT credit and distributed it to their branch office in Secunderabad. Therefore, if these allegations are true, the demand, if any, and penalties, if any, is imposable on the corporate office. Although, the appellant and their corporate office are part of the same legal entity, it is inconceivable that their branch office in Secunderabad who have received credit through ISD invoices from their corporate office has full knowledge of how the credit was availed by their corporate office and how it was transferred to their various branch offices across the country.

c) As far as the appellant is concerned, they have legitimately taken credit on the basis of the ISD invoices which they received from their own corporate office. We, therefore, find no ground to hold that appellant has not discharged his responsibility under Rule 9 regarding the admissibility of the credit to them. The demand, interest and penalties are therefore, not sustainable

Accordingly the appeal filed by the appellants was allowed.

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Darkness and light, enjoyment of the world and enjoyment of God will never go together.

— *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

[2019] 212 Comp Cas 121 (NCLAT)

[Before the National Company Law Appellate Tribunal – New Delhi]

Surjeet Singh vs. Prowess International P. Ltd. and Others

In the petition for oppression, it is not always that proof is sufficient and that it is not a question merely of interest of the petitioner but interest of the shareholders as a whole was material".

Brief

This appeal has been filed against the judgment and order passed by the National Company Law Tribunal, ("**NCLT**"), Kolkata Bench, Kolkata. In the said order, the NCLT has rejected the applicant's original petition for oppression and mismanagement.

The submission made by the applicants is as follows.

1. The appellant and the respondents No. 2 and 4 were the founding members of Prowess International P. Ltd ("**Company**") and having equal shareholdings.
2. The shares held by appellant, respondents No. 2 and 4 ("R2 and R4, respectively) and another partnership firm.
3. In the said partnership, all the three were equal partners.
4. Respondent No. 3 became a director but was not having any shareholding.
5. R2 and R3 were planning to take over the Company by taking control of all administrative and financial powers; and to effectuate this, R2 was appointed as CEO, even though he had objected.
6. There were incidents of humiliation and non-cooperative behaviour of R2 and R3 against him.
7. Appellant, then decided to sell his shares based on the valuation to be arrived at by the statutory auditor.
8. Since incorporation, only appellant and R2 were the bank signatories. However, after appellant indicated his intention of selling his shares, R2 and R3 has also inducted R3 as bank signatory and change the operating process by making, any director, as requirement, to operate the bank accounts.
9. Appellant has raised his objection and insisted on his participation in the affairs of the Company.
10. R2 has put a proposal for the removal of the appellant as a director and sent a letter to that effect asking for his reply.

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11. Due to this, the appellant had filed company petition before the CLB.
12. After convincing that Company petition has *prima facie* case, the CLB has passed an interim order for maintaining the *status quo* regarding the shareholding pattern and composition of board of directors. CLB has also mentioned that this *status quo* shall be effective until next date of hearing.
13. Subsequently, the respondents continued with their oppressive acts and passed a resolution withdrawing duties, functions and authorities of appellant as the director and same were taken over by the R2.
14. The appellant's official mobile number was deactivated, official email was blocked and he was stopped from coming to the office.
15. The application was made to CLB on this and also on non-payment of remuneration and that both R2 and R3 were withdrawing salaries while they are claiming before CLB, that Company is at a loss.
16. R4 has transferred his shares to R3, who was not a shareholder.
17. On filing revised application before CLB about transfer of shares, R4 and R3 claimed that shares were transferred even before the CLB order, however no documents were produced to that effect.

From respondent side, it has been submitted that:

1. Referring to the petition, it was pointed out that there was no prayer as to grievances for transfer of shares from R4 to R3.
2. The appellant has incorporated another company and divested the business opportunities of the Company, thus justifying the steps taken by R2 and R3. The proof submitted before the CLB were referred in this regard.
3. The appellant has sent letter to bank on change in signatories which has resulted into problem in operating Company's bank accounts.
4. The other incidents of disputes related to other clients due to appellant were also submitted.
5. On remuneration payment, it was claimed that they have been taking the same since 2011. Due to appellant's behaviour, Company's profits were affected and went down and hence his executive jobs was withdrawn in the EGM.

Judgment

NCLAT has accepted the application and has found that R2 and R3 did act oppressively with the appellant and also R4, who has given his tacit consent. However, it has observed that winding up of the Company would prejudice the members, but otherwise facts suggest that it is just and equitable to do so. NCLAT has ordered to give option to R2 and R4 wherein they will be given first option to purchase shares of the appellant. If, they fail to do so, then the appellant should get benefit of discount to purchase the shares of R2 and R4.

NCLAT has set aside the transfer of shares from R4 to R3 and further allowed the appellant to function as director and that he is also eligible for the remuneration till the shares are purchased by R2 and R4. It has remitted back the matter to NCLT with certain direction for implanting the above order.

NCLAT also directed the NCLT to pass suitable order on sale of shares by the appellant to the respondents at a price arrived as per valuation report. If not accepted, then appellant can purchase shares of respondents at a discount from price fixed by valuer. The following observations were made by the NCLAT.

1. On withdrawals of remuneration, the NCLAT has noted that in spite of CLB order for *status quo*, the powers of the appellant were withdrawn and his

remuneration was stopped. It has also referred to the CLB's order taking note of this as well as respondents confirmation about payment of all dues. The said order also extended the period of earlier interim-order to maintain the *status quo.* In subsequent hearing also, both the parties were directed to file their rejoinder etc., and *status quo* was continued.

2. Instead of filing status of remuneration payment, the supplemental rejoinder from respondents has given all types of counter claims and allegations against the appellants as mentioned in their submission above.

3. The NCLT has noted the same but simply accepted the respondent's submission and not observing the CLB's order on maintaining *status quo.*

4. Thus, NCLT has not considered the above facts and thus both R 2 and R 23 have acted in an oppressive manner.

5. The appellant submission on figures of profit for the year ended 2014 and 2015, shows decline in profit from 2014 to 2015. However, as per MGT9, the R2 and R3 has taken substantial amount as salaries but nil amount has been paid to the appellant and no dividend has been declared. Same is for 2016 also. The maximum managerial remuneration payable under section 197 also pointed out and that both R2 and R3 has taken more remuneration than eligible. Thus, it is to be considered as siphoning of funds as per the appellant's submission. The appellant submission is therefore accepted on the said count.

6. On transfer of shares, NCLAT has looked into dates of execution of share transfer deed, the CLB orders, the confirmation from R2 and R3 on shareholding pattern in their submission. NCLAT accepted the contention and substance of the appellant that the share transfer was forged and transfer shown prior to March was backdated, while the notarisation was done in the month of May. Thus, per section 108(1)(a) of the Companies Act, 1956, share transfer forms had to be submitted to the prescribed authority before execution, hence it is not justifiable that RoC will stamp the share transfer form, which has already been executed. NCLAT has concluded that the respondents were acting in sync with each other to oppress the appellant.

7. On appellant having the other business interest, it has noted that the Appellant has already resigned from other business and the respondents were not taking note of it and trying to make a case out of it.

8. On NCLT's observation on participating of tender from Usha Martin and that Appellant has participated through other company, NCLAT took note of the quotation amount of both the companies and observed that if appellant had privy to the inside information on price quote, the difference could not be so low by couple of lakhs of rupees.

9. Upon going through the NCLT's reasoning order, NCLAT has observed that the learned Tribunal has not appreciated the matter in proper perspective,

10. The judgment in the matter of *M.S.D.C Radharamanan vs. M.S.D.Chandrasekara Raja, [2008] 143 Comp Cas 97 (SC); [2008]* 6 SCC 750 as relied by the appellant wherein the Hon. Supreme Court has observed that "it is not a question merely of interest of the petitioner but interest of the shareholders as a whole was material". Thus, the argument of the appellant that NCLT just could not have simply dismissed the petition was also accepted by the NCLAT.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA – Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circulars and Notifications issued by RBI and discussed recent compounding orders.

A) Amendments through Notification/ Circulars

I) New External Commercial Borrowings (ECB) Framework [A.P. (DIR Series) Circular No. 17 dated January 16, 2019]

The Principal Regulations governing the ECB policies have been rationalised through the Notification 3(R)/2018-RB "Foreign Exchange Management (Borrowing and Lending) Regulations, 2018" dated December 17, 2018, *vide* G.S.R. 1213(E) dated December 17, 2018.

RBI has now put in place the extant framework for ECB and Rupee Denominated Bonds and in doing so has rationalized the new ECB framework to improve the ease of doing business.

This being a new framework, the salient features are summarised in detail in the following paragraphs:

In the new framework, the lender should be resident of FATF or IOSCO compliant country. These two terms are defined as follows:

1) Important Definitions

a. **FATF compliant country:** A country that is a member of Financial Action Task Force (FATF) or a member of a FATF-Style Regional Body; and should not be a country identified in the public statement of the FATF as (i) A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or (ii) A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

b. **IOSCO compliant country:** A country whose securities market regulator is a signatory to the International Organisation of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Securities and Exchange Board of India (SEBI) for information sharing arrangements.

2) ECB framework

The framework for raising loans through ECB (hereinafter referred to as the ECB Framework) comprises the following two options:

Sr. No.	Parameters	FCY denominated ECB	INR denominated ECB
i	Currency of borrowing	Any freely convertible Foreign Currency	Indian Rupee (INR)
ii	Forms of ECB	– Loans including bank loans; – Floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); – Trade credits beyond 3 years; – FCCBs; – FCEBs; and – Financial Lease.	– Loans including bank loans; – Floating/ fixed rate notes/ bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); – Trade credits beyond 3 years; – Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas (RDBs), which can be either placed privately or listed on exchanges as per host country regulations.
iii	Eligible borrowers	All entities eligible to receive FDI. Further, the following entities are also eligible to raise ECB: a) Port Trusts; b) Units in SEZ; c) SIDBI; d) EXIM Bank; and e) Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/trusts/ cooperatives and Non-Government Organisations (permitted only to raise INR ECB).	
iv	Recognised lenders	The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECBs. However, a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders; b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and	

<table>
<tr><th>Sr. No.</th><th>Parameters</th><th>FCY denominated ECB</th><th>INR denominated ECB</th></tr>
<tr><td></td><td></td><td colspan="2">c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs).

Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.</td></tr>
<tr><td>v</td><td>Minimum Average Maturity Period</td><td colspan="2">Minimum average maturity period (MAMP) will be 3 years. However, manufacturing sector companies may raise ECBs with MAMP of 1 year for ECB up to USD 50 million or its equivalent per financial year. Further, if the ECB is raised from foreign equity holder and utilised for working capital purposes, general corporate purposes or repayment of Rupee loans, MAMP will be 5 years. The call and put option, if any, shall not be exercisable prior to completion of minimum average maturity.</td></tr>
<tr><td>vi</td><td>All-in-cost ceiling per annum</td><td colspan="2">Benchmark rate plus 450 bps spread.</td></tr>
<tr><td>vii</td><td>Other costs</td><td colspan="2">Prepayment charge/ Penal interest, if any, for default or breach of covenants should not be more than 2 per cent over and above the contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.</td></tr>
<tr><td>viii</td><td>End-uses (Negative list)</td><td colspan="2">The negative list, for which the ECB proceeds cannot be utilised, would include the following:
a) Real estate activities
b) Investment in capital market
c) Equity investment
d) Working capital purposes except from foreign equity holder
e) General corporate purposes except from foreign equity holder
f) Repayment of Rupee loans except from foreign equity holder
g) On-lending to entities for the above activities.</td></tr>
<tr><td>ix</td><td>Exchange rate</td><td>Change of currency of FCY ECB into INR ECB can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate, which is less than the rate prevailing on the date of agreement, if consented to by the ECB lender.</td><td>For conversion to Rupee, exchange rate shall be the rate prevailing on the date of settlement.</td></tr>
</table>

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Sr. No.	Parameters	FCY denominated ECB	INR denominated ECB
x	Hedging provision	The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Infrastructure space companies shall have a board approved risk management policy and are required to mandatorily hedge 70 per cent of their ECB exposure in case average maturity of ECB is less than 5 years. The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of ECB and report the position to RBI through Form ECB 2 returns. The following operational aspects with respect to hedging should be ensured: **Coverage**: The ECB borrower will be required to cover principal as well as coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e., the day liability is created in the books of the borrower). **Tenor and rollover:** A minimum tenor of one year of financial hedge would be required with periodic rollover duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of ECB.	The overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back-to-back basis.

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Sr. No.	Parameters	FCY denominated ECB	INR denominated ECB
		Natural Hedge: Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows / revenues in matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the offsetting exposure has the maturity/cash flow within the same accounting year. Any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as natural hedge.	
xi	Change of currency of borrowing	Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.	Change of currency from INR to any freely convertible foreign currency is not permitted.

Limit and leverage: All eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under auto route. Further, in case of FCY denominated ECB raised from direct foreign equity holder ECB liability-equity ratio for ECBs raised under the automatic route cannot exceed 7:1.

However, this ratio will not be applicable if outstanding amount of all ECBs, including proposed one, is up to USD 5 million or equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio issued, if any, by the sectoral or prudential regulator concerned.

3) Issuance of Guarantee, etc., by Indian banks and Financial Institutions

Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted. Further, financial intermediaries (viz., Indian banks, All India Financial Institutions, or NBFCs) shall not invest in FCCBs/ FCEBs in any manner whatsoever.

4) Parking of ECB proceeds

ECB proceeds are permitted to be parked abroad as well as domestically.

5) Procedure of raising ECB

All ECBs can be raised under the automatic route if they conform to the parameters prescribed under this framework. For approval route cases, the borrowers may approach the RBI with an application in Form ECB for examination through their AD Category I bank.

6) Reporting Requirements

Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

a) **Loan Registration Number (LRN):** Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank. To obtain the LRN, borrowers are required to submit duly certified Form ECB, which also contains terms and conditions of the ECB

b) **Changes in terms and conditions of ECB:** Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the DSIM through revised Form ECB at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.

c) **Monthly Reporting of actual transactions:** The borrowers are required to report actual ECB transactions through Form ECB 2 through the AD Category I bank on monthly basis so as to reach DSIM within seven working days from the close of month to which it relates. Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.

d) **Late Submission Fee (LSF) for delay in reporting:** Any borrower, who is otherwise in compliance of ECB guidelines, can regularise the delay in reporting of drawdown of ECB proceeds before obtaining LRN or delay in submission of Form ECB 2 returns, by payment of late submission fees as detailed in the following matrix:

Sr. No.	Type of Return/Form	Period of delay	Applicable LSF
1	Form ECB 2	Up to 30 calendar days from due date of submission	INR 5,000
2	Form ECB 2/Form ECB	Up to three years from due date of submission/date of drawdown	INR 50,000 per year
3	Form ECB 2/Form ECB	Beyond three years from due date of submission/date of drawdown	INR 100,000 per year

7) Powers delegated to AD Category I banks to deal with ECB cases

The designated AD Category I banks can approve any requests from the borrowers for changes in respect of ECBs, except for FCCBs/FCEBs, duly ensuring that the changed conditions, including change in name of borrower/lender, transfer of ECB and any other parameters, comply with extant ECB norms and are with the consent of lender(s). Further, the following changes can be undertaken under automatic route:

a) **Change of the AD Category I bank:** AD Category I bank can be changed subject to obtaining no objection certificate from the existing AD Category I bank.

b) **Cancellation of LRN:** The designated AD Category I banks may directly approach DSIM for cancellation of LRN for ECBs contracted, subject to ensuring that no draw down against the said LRN has taken place and the monthly ECB-2 returns till date in respect of the allotted LRN have been submitted to DSIM.

c) **Refinancing of existing ECB:** The designated AD Category I bank may allow refinancing of existing ECB by raising fresh ECB provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB. Further, refinancing of ECBs raised under the previous ECB framework may also be permitted, subject to additionally ensuring that the borrower is eligible to raise ECB under the extant framework. Raising of fresh ECB to part refinance the existing ECB is also permitted subject to same conditions. Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and for Maharatna/Navratna public sector undertakings.

d) **Conversion of ECB into equity:** Conversion of ECBs, including those which are matured but unpaid, into equity is permitted subject to the certain conditions.

e) **Security for raising ECB:** AD Category I banks are permitted to allow creation/ cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/ or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised / raised by the borrower, subject to satisfying themselves that:

   i. The underlying ECB is in compliance with the extant ECB guidelines,

   ii. There exists a security clause in the Loan Agreement requiring the ECB borrower to create/ cancel charge, in favour of overseas lender / security trustee, on immovable assets / movable assets / financial securities / issuance of corporate and / or personal guarantee, and

   iii. No objection certificate, as applicable, from the existing lenders in India has been obtained in case of creation of charge.

   Once the aforesaid stipulations are met, the AD Category I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the certain conditions given in the framework.

8) Special Dispensations under the ECB framework:

a) **ECB facility for Oil Marketing Companies**: Public Sector Oil Marketing Companies (OMCs) can raise ECB for working capital purposes with minimum average maturity period of 3 years from all recognised lenders under the automatic route without mandatory hedging and individual limit requirements. The overall ceiling for such ECBs shall be USD 10 billion or equivalent. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECBs. All other provisions under the ECB framework will be applicable to such ECBs.

b) ECB facility for Startups: Startups are allowed to raise ECB under the automatic route as per the following framework:

   i. **Eligibility**: An entity recognised as a Startup by the Central Government as on date of raising ECB.

   ii. **Maturity**: Minimum average maturity period will be 3 years.

   iii. **Recognised lender:** Lender / investor shall be a resident of a FATF compliant country. However, foreign branches/subsidiaries of Indian banks and overseas entity in which Indian entity has made overseas direct investment as per the extant Overseas Direct Investment Policy will not be considered as recognized lenders under this framework.

iv. **Forms**: The borrowing can be in form of loans or non-convertible, optionally convertible or partially convertible preference shares.

v. **Currency**: The borrowing should be denominated in any freely convertible currency or in Indian Rupees (INR) or a combination thereof. In case of borrowing in INR, the non-resident lender, should mobilise INR through swaps/outright sale undertaken through an AD Category-I bank in India.

vi. **Amount**: The borrowing per Startup will be limited to USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.

vii. **All-in-cost**: Shall be mutually agreed between the borrower and the lender.

viii. **End uses**: For any expenditure in connection with the business of the borrower.

ix. **Conversion into equity**: Conversion into equity is freely permitted subject to Regulations applicable for foreign investment in Startups.

x. **Security**: The choice of security to be provided to the lender is left to the borrowing entity. Security can be in the nature of movable, immovable, intangible assets (including patents, intellectual property rights), financial securities, etc. and shall comply with foreign direct investment / foreign portfolio investment / or any other norms applicable for foreign lenders / entities holding such securities. Further, issuance of corporate or personal guarantee is allowed. Guarantee issued by a non-resident(s) is allowed only if such parties qualify as lender under ECB for Startups. However, issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, all India Financial Institutions and NBFCs is not permitted.

xi. **Hedging**: The overseas lender, in case of INR denominated ECB, will be eligible to hedge its INR exposure through permitted derivative products with AD Category – I banks in India. The lender can also access the domestic market through branches/ subsidiaries of Indian banks abroad or branches of foreign bank with Indian presence on a back to back basis.

Startups raising ECB in foreign currency, whether having natural hedge or not, are exposed to currency risk due to exchange rate movements and hence are advised to ensure that they have an appropriate risk management policy to manage potential risk arising out of ECBs.

xii. **Conversion rate:** In case of borrowing in INR, the foreign currency - INR conversion will be at the market rate as on the date of agreement.

xiii. **Other Provisions**: Other provisions like parking of ECB proceeds, reporting arrangements, powers delegated to AD banks, borrowing by entities under investigation, conversion of ECB into equity will be as included in the ECB framework. However, provisions on leverage ratio and ECB liability: Equity ratio will not be applicable. Further, the Start-ups as defined above [8.2. (i)] as well as other start-ups which do not comply with the aforesaid definition but are eligible to receive FDI, can also raise ECBs under the general ECB route/ framework.

9. Borrowing by Entities under Investigation

All entities against which investigation / adjudication / appeal by the law enforcing agencies for violation of any of the provisions of the Regulations under FEMA pending, may raise ECBs as per the applicable norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. The borrowing entity should inform about pendency of such investigation / adjudication / appeal to the AD Category-I bank / RBI as the case may be.

10. ECB by entities under restructuring

An entity which is under restructuring scheme/ corporate insolvency resolution process can raise ECB only if specifically permitted under the resolution plan.

11. Dissemination of information

For providing greater transparency, information with regard to the name of the borrower, amount, purpose and maturity of ECB under both Automatic and Approval routes are put on the RBI's website, on a monthly basis, with a lag of one month to which it relates.

12. Compliance with the guidelines

The primary responsibility for ensuring that the borrowing is in compliance with the applicable guidelines is that of the borrower concerned. Any contravention of the applicable provisions of ECB guidelines will invite penal action under the FEMA.

II) Comments/Key takeaways from RBI/2018-19/109 – A.P. (DIR Series) Circular No. 17 dated 16th January, 2019, on New External Commercial Borrowings (ECB) Framework

i. **Merging of Tracks**: Under previous ECB framework, ECBs could be raised under three different tracks viz., Track I, Track II and Track III. In the revised ECB framework, Tracks I and II are merged as "Foreign Currency denominated ECB" and Track III and Rupee Denominated Bonds framework are merged as "Rupee Denominated ECB".

ii. **Eligible Borrowers**: In the old framework, eligible borrowers were categorised differently as per the track through which the ECBs were raised. This has been expanded in the new framework, to include all entities eligible to receive FDI. Additionally, Port Trusts, Units in SEZ, SIDBI, EXIM Bank, registered entities engaged in micro-finance activities, viz., registered not for profit companies, registered societies/trusts/cooperatives and non-government organisations can also borrow under this framework.

iii. **Recognised Lender**: Similar to the eligible borrowers, in the old framework, recognised lenders were categorised differently as per the track through which the ECBs were raised. In the new framework, the lender should be resident of FATF or IOSCO compliant country. Multilateral and Regional Financial Institutions, Individuals and Foreign branches / subsidiaries of Indian banks can also be lenders.

iv. **Minimum Average Maturity Period (MAMP):** In the new framework, MAMP will be 3 years for all ECBs. ECB raised from foreign equity holder and utilised for specific purposes the MAMP would be 5 years. Similarly, for ECB up to USD 50 million per financial year raised by manufacturing sector, which has been given a special dispensation, the MAMP would be 1 year.

v. **Late Submission Fee (LSF) for delay in Reporting:** In the old framework, delay in complying with reporting requirements for ECBs raised was considered as contravention and the entity was required to apply for compounding of such contraventions. In the new framework, any borrower can regularise the delay by payment of LSF.

vi. **Reporting Requirements:** In the old framework, in order to obtain a Loan Registration Number (LRN), borrowers were required to file Form 83. In the new framework, the LRN has to be obtained by filing Form ECB to the AD Category I bank. Also the changes in terms and conditions of ECB were to be reported to the Department of Statistics and Information Management (DSIM) through revised Form 83 in the old framework. The same has to be reported to DSIM through Form ECB in the new framework.

III) Issues / ambiguities which may require further clarification

i. Under the new framework eligible borrowers include all entities eligible to receive FDI.

Under Notification 20(R) Foreign Direct Investment and Foreign Investment are defined separately under Regulation 2(xvii) as follows:-

xvii) 'Foreign Direct Investment' (FDI) means investment through capital instruments by a person resident outside India in an unlisted Indian company; or in 10 per cent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company;

(xviii) 'Foreign Investment' means any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of an LLP;

Therefore, it appears that investment in LLPs may not be considered as Foreign Direct Investment (FDI) and may not be eligible to raise ECB. In borrowers category in Form ECB, there is mention of LLP.

ii. Overseas Investment in JV/ WOS.

The guidelines prohibit use of borrowed funds for investment in equity capital. This means that ECB borrowings for investment in JV/ WOS may not be permissible.

However in Form ECB, in Box II, the purpose code at S. No. 7 is as follows

7 OI Overseas investment in JV/ WOS. This may create some ambiguity.

iii. It appears that restrictions on on-lending of borrowed funds will apply to only following activities -

a) Real estate activities.

b) Investment in capital market.

c) Equity investment.

d) Working capital purposes except from foreign equity holder.

e) General corporate purposes except from foreign equity holder.

f) Repayment of Rupee loans except from foreign equity holder.

Does this mean restrictions on on-lending of borrowed funds will be governed by other statutes and not FEMA?

iv. Meaning of General Corporate Purpose is not provided. Whether loans to Employee directors and other employees granted as per the extant policy of the company would amount to utilization of funds for general corporate purposes or on-lending of funds?

v. The new guidelines prescribe late submission fees for Form ECB-2. Non-payment of LSF will attract compounding. Whether compounding fees will be in addition to LSF or will be independent.

A clarification from RBI on above aspects may help resolve the ambiguity.

(Source: AP Dir. Series Circular No. 17 dated 16th January, 2019)

We have discussed below few recent compounding orders issued by RBI

A. Inbound Investment (FEMA 20/2000-RB)/(FEMA 20(R)/2017-RB)

1. Increase in foreign investment beyond the sectoral cap of 49% without the prior approval of the Government of India.

Applicant	Indus Towers Limited
Compounding Application Number	C.A. NDL 299/2018
Compounding Authority Name	Foreign Exchange Department, New Delhi
Amount imposed under Compounding Order	₹ 50,634/-
Date of order	20th November, 2018
Facts of the case	The applicant company is a joint venture of the Bharti group, Vodafone group and Idea group and the level of foreign investment (direct and indirect) in the company initially was 46.85 i.e., within the 49% the sectoral cap permitted under the automatic route under the FDI Policy dated August 28, 2017. Subsequently, the Idea group allotted equity shares to its promoters (including non-resident entities) and consequently Idea became a foreign owned company and the indirect foreign investment in the applicant company increased by 11.15% and, therefore, the aggregate foreign investment (direct and indirect) in the applicant company increased to 58% (i.e., beyond 49%). The company approached Department of Telecommunications (DoT), Ministry of Communications for post-facto approval for increase in indirect foreign investment. The approval was granted *vide* DoT letter dated July 17, 2018 subject to compounding from RBI.
Contravention	<u>Increase in foreign investment beyond the sectoral cap of 49% without the prior approval of the Government of India:</u> Regulation 16B of extant Notification No. FEMA 20(R)/2017-RB states that total foreign investment in an Indian entity shall not exceed the sectoral cap. The sectoral cap for Telecom services (including Telecom Infrastructure Provider Category I) is 49% under automatic route and beyond 49% it is under the Government approval route.

Comments	It is essential to periodically monitor shareholding structure of the shareholders to ensure that direct/indirect foreign holding in the company does not exceed the sectoral cap.

2. Delay in reporting the transfer of shares in form FC-TRS

Applicant	Jeetender Prashad
Compounding Application Number	C.A. HYD 329
Compounding Authority Name	Foreign Exchange Department, Hyderabad
Amount imposed under Compounding Order	₹ 13,080/-
Date of order	27th December, 2018
Facts of the case	The applicant is a resident shareholder of M/s. Kerasoft Eyecare Private Limited holding 9,999 equity shares. The applicant received an inward remittance from Contact Lens Precision Laboratories Limited (purchaser) through M/s. Ultravision International Limited, which is a wholly owned subsidiary of the purchaser towards sale purchase agreement for transfer of 9,500 equity shares of M/s Kerasoft Eyecare Private Limited. Pursuant to the remittance, the form FC-TRS filed by the applicant is not certified by the AD due to certain discrepancies in the submission of documents and thus, applicant remained to be the legal owner of the shares. On account of Non-Transfer, applicant and purchaser mutually agreed to unwind the transaction and hence the applicant had remitted back the amount received to the purchaser.
Contravention	Paragraph 10(i) of Schedule 1 to FEMA Notification No. 20 dated May 03, 2000 states that "in case of transfer of shares of an Indian company by way of sale from a person resident in India to a person resident outside India or vice versa, the transferor/transferee who is resident in India should report to AD bank a report in form FC-TRS within the time prescribed by RBI."
Comments	Though Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations, 2000 has been replaced by revised regulations; Regulation 13.1 (4) of extant FEMA 20(R)/2017-RB dated 07/11/2017 corresponds to Regulation 10(i) of Schedule 1 of erstwhile FEMA 20/2000- RB dated May 3, 2000. Though this case is not related to transfer, any contravention related to the requirements regarding the transfer of shares per se or any requirement regarding the process of transfer has been considered as a contravention of the said provision of FEMA by the RBI.

B. Outbound Investment (FEMA 120/2004-RB)

1. Disinvestment of JV within one year of Equity Remittance

Applicant	Parijat Industries India Private Limited
Compounding Application Number	C.A. 4701/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 74,982/-
Date of order	31st October, 2018
Facts of the case	The applicant company had an overseas wholly owned subsidiary (WOS) viz., Parijat Industries FZE in UAE. Disinvestment of the aforesaid WOS was undertaken which involved write-off within one year from the date of Overseas Direct Investment.
Selected Contravention	<u>Disinvestment of JV within one year of Equity Remittance</u>: Regulation 16(1)(v) of the Notification no. FEMA 120/2004-RB, Dated 7-7-2004, states that "an Indian Party may transfer, by way of sale to another Indian Party any share or security held by it in a JV or WOS outside India subject to the condition that the overseas concern has been in operation for at least one full year and the Annual Performance Report together with the audited accounts for that year has been submitted to the Reserve Bank."
Comments	It is very often found that Indian entity incorporate WOS swiftly but, later on realize that it may not be feasible for WOS to run the operations due to various reasons. In such cases, it should be ensured that the overseas WOS has been in operation for at least one full year and filing of APR has been done as per the relevant regulations.

2. Method of Funding of ODI through cash

Applicant	Tavisca Solutions Private Limited
Compounding Application Number	CA No 4727/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 17,891/-
Date of order	11th December, 2018
Facts of the case	The applicant had set-up a wholly owned subsidiary in Tavisca LLC in USA. Mr. Mahendra Yadav, Managing Director of the applicant company had invested USD 500 (₹ 30,766/-) towards capital investment in Cash in the overseas WOS from the amount of foreign exchange carried abroad by Mr. Mahendra Yadav for a business trip.

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Selected Contravention	Method of Funding of ODI through cash: Regulation 6(3) of the Notification no. FEMA 120/2004-RB, Dated 7-7-2004 prescribes modes of funding of Overseas Direct investment (ODI). ODI by way of cash deposit is not a permitted method of funding as per the said regulation.

C. Borrowing or Lending in Rupees (FEMA 4/2000-RB)

1. Borrowing in rupees without the issuance of Non-Convertible Debenture (NCDs)

Applicant	Glenmark Life Sciences Limited
Compounding Application Number	C.A. 4758/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 75,300/-
Date of order	7th December, 2018
Facts of the case	Shri Damanjit Singh a Non-Resident Indian (NRI) based out of Unites States of America was one of the Director and shareholder of the applicant company since its incorporation. Shri Damanjit Singh had remitted ₹ 38,00,000/- by way of inward remittances to the applicant. Out of the above amount, applicant had issues shares to Shri Damanjit Singh to the extent of ₹ 33,330/- and balance amount of ₹ 37,66,670/- was treated as loan in the books of the applicant.
Contravention	Borrowing in rupees without the issuance of Non-Convertible Debenture (NCDs): Regulation 5(1) of FEMA Notification No. 4/2000-RB states that "a company incorporated in India may borrow in rupees on repatriation or non-repatriation basis from a non-resident Indian by way of investment in non-convertible debenture (NCDs) subject to the condition specified therein. Here, Applicant took a rupee loan from NRI director without the issuance of Non-Convertible Debenture (NCDs).

D. Foreign currency accounts by a person resident in India Regulations (FEMA 10/2000-RB)

1. Credit of remittances received towards FDI in the EEFC account

Applicant	Apache Footwear India Private Limited
Compounding Application Number	CA No 4724/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 38,40,890/-

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Date of order	5th December, 2018
Facts of the case	The applicant had received multiple foreign inward remittances from Apache Investment Holding Pte Ltd as foreign direct investment. Out of these, some of the inward remittances received were erroneously credited to/received in the EEFC account instead of the current account of the applicant company. The funds were subsequently transferred to the current account of the applicant.
Contravention	Credit of remittances received towards FDI in the EEFC account: Regulation 4 of Notification No. FEMA 10/2000-RB regulates the opening, holding and maintenance of EEFC Account. Paragraph 2 of Schedule I of the Notification ibid lists the permissible credits to the EEFC account. FDI proceeds does-not form a part of such list.
Comments	Though Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2000 has been replaced by revised regulations; Regulation 4 r.w. paragraph 2 of Schedule 1 of extant FEMA 10(R)/2015-RB dated 21/01/2016 corresponds to Regulation 4 r.w. paragraph 2 of Schedule 1 of erstwhile FEMA 10/2000- RB dated May 3, 2000. Schedule 1 of FEMA Notification No.10(R)/2015-RB prescribes permissible credits to the EEFC Account. However, credit of remittance received towards FDI is not a permissible credit to the EEFC account as per the said notification.

E. Regularisation of assets held abroad by a person resident in India (FEMA 348/2000-RB)

1. Retention of assets abroad that were declared under the Black Money Act beyond stipulated period from the date of declaration without prior approval of Reserve Bank

Applicant	Pradeep Khemka
Compounding Application Number	CA No 4742/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 81,949/-
Date of order	01st October, 2018
Facts of the case	The applicant Shri Pradeep Khemka, a resident Indian, declared foreign assets to the extent of USD 30,46,861 under the Black Money (undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015, and paid a tax of ₹ 11,57,19,780 on the same. The applicant remitted to India part amount after liquidation of his foreign assets. However, the balance part amount was not remitted to India within the specified period. No approval was sought from RBI by the applicant for retaining the amount beyond the specified period.

	The balance part amount was repatriated to India beyond the specified time period. The applicant then approached the Kolkata regional office of Reserve Bank, for post facto approval. The contravention has since been examined and regularized by the Reserve Bank *vide* approval subject to compounding.
Contraventions	Retention of assets abroad that were declared under the Black Money Act beyond stipulated period from the date of declaration without prior approval of Reserve Bank: Regulation 4 of FEMA Notification No. 348 provides that where the declarant intends to continue to hold the asset so declared, he shall apply to the Reserve Bank within 180 days from the date of declaration, for permission under the relevant provisions of the Act, or rules and regulations framed thereunder, if such permission is necessary as on the date of application. Provided further that where the declarant does not intend to hold the asset so declared or the permission to hold such asset is refused by the Reserve Bank, as the case may be, the declarant shall dispose of the said asset within 180 days from the date of making such declaration or the date of receipt of the communication from the Reserve Bank conveying refusal of permission or within such extended period as may be permitted by the Reserve Bank and bring back the proceeds to India immediately through the banking channel.

F. Acquisition of Immovable property in India (FEMA 21/2000-RB)

1. Acquisition of immovable property in India by Sri Lankan Citizen without RBI permission.

Applicant	Mrs Rajini Kodeswaran
Compounding Application Number	C.A. No. 76/2018
Compounding Authority Name	Foreign Exchange Department, New Delhi
Amount imposed under Compounding Order	₹ 18,78,208/-
Date of order	28th August, 2018
Facts of the case	Mrs. Rajini Kodeswaran, a Sri Lankan citizen had acquired an immovable property in Chennai, India in the year 2008 without obtaining prior permission from the Reserve Bank of India. Subsequently, she had constructed a flat on the same property. The immovable property was acquired for total consideration of ₹ 6,84,000/- and the cost of construction of flat is ₹ 32,97,085/-. The above is a contravention of Regulation 7 of FEMA Notification No. 21/2000-RB dated May 03, 2000. In view of the above, she was advised to sell the immovable property to a person resident in India who is citizen of India and not to repatriate sale proceeds of the property without prior approval of the RBI. The property under reference was sold by the applicant on May 12, 2017 for total sale consideration of ₹ 44,00,000/-. As per the valuation report submitted by applicant the value

	of land has been appreciated to ₹ 24,82,350 since 2008, by virtue of which the applicant has earned ₹ 17,98,350 /- i.e. ₹ 24,82, 350/- minus ₹ 6,84,000/- as undue gain. Sale proceeds received by the applicant were used to repay the loan taken by the applicant from her parents, brother and to meet other expenditures. Repayment made by her to parents and brother for expenditure on pilgrimage, medicines, medical check-up and for holidays in India, may also be deemed as money already repatriated outside India as all of them were liable to bring money from abroad for expenses in India. The purchase price of the immovable property under reference i.e. ₹ 6,84,000 and the cost of construction of flat was ₹ 32,97,085/- aggregating to ₹ 39,81,085/- has been considered as the amount of contravention. Further, the cost of land has been appreciated to ₹ 24,82,350/- hence the difference i.e. ₹ 17,98,350/- has been considered as the undue gain.
Contravention	Acquisition of immovable property in India by Sri Lankan Citizen without RBI permission: Regulation 7 of Notification No. FEMA-21/2000-RB dated May 3, 2000 states that no person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau or Hong Kong without prior permission of the Reserve Bank shall acquire or transfer immovable property in India, other than lease, not exceeding five years. Hence, the aforesaid immovable property in Chennai acquired by Mrs. Rajni Kodeswaran, Sri Lankan Citizen, without Reserve Bank's permission is a contravention of Regulation 7 of Notification No. FEMA 21/2000-RB dated May 03, 2000.
Comments	Though Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India)) Regulations, 2000 has been replaced by revised regulations; Regulation 9 of extant FEMA 21(R)/2017-RB dated 7-11-2017 corresponds to Regulation 5(1) of erstwhile FEMA 20/2000- RB dated May 3, 2000. As per Master Direction on Compounding of Contravention under FEMA, if it is established that the contravenor has made undue gains, the amount thereof may be neutralized to a reasonable extent by adding the same to the calculation of compounding amount. In this case, RBI has correctly neutralized the undue gain as per the provision laid down in the aforesaid Master Direction.

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So long as there is selfishness in the heart, so long is love of God impossible.

— *Swami Vivekananda*

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CA Prachi Parekh

Finance Bill 2019 : Amendments to Income-tax Act

The Finance Bill, 2019 (1), presented on 1st February 2019, was the first among recent times to be presented by a rank-holder Chartered Accountant, most of his predecessors being ministers holding degree in law. The interim Finance Minister was faced with a challenge to present the Interim Budget that ought to have balanced the needs of an election bound government on one hand, and a rapidly growing economy on the other. The brown brief case, he carried, apparently containing the Finance Bill to be presented incited several comments from the media making its appearance in several photographs.

The part of the Minister's speech preceding the introduction of amendments in direct tax began with emphasis on simplification of direct tax systems which would result in benefit to taxpayers. The path-breaking technologically intense online interface of the tax department will now focus on being assessee friendly, and shall aim at processing of returns within 24 hours with refunds being issued simultaneously. It also detailed some robust statistics with regards to increase in both tax collection as well as increase in the volume of returns filed, pointing at 80% growth in tax base.

The general sentiment around has been that ahead of the general elections slated to be held later this year, the budget is a pro-poor, pro-farmer one, with limited benefits for the middle class.

Though the Finance Minister mentioned that reducing the tax burden on the middle class has always been the priority, ever since the Government took over in 2014, one wonders whether the measures taken for doing so have really proved to be enough in reducing the tax burden, or they have been over-shadowed with the measures taken to ensure compliance and the widening of the tax base.

This article in the following paragraphs, deals with the proposed amendments of the Finance Bill 2019, pertaining to direct taxes.

Rates of tax & Rebate

Rates of Tax

There has been no change proposed in the tax slabs and the tax rates, and the same rates have been continued as the last financial year, i.e. Financial Year 2018-19.

Let us recapitulate the important tax rates to be noted for the coming Financial Year:

Following are the tax slabs applicable for Assessment Year 2020-21:

(in ₹)

Category of Individual	Nil	5%	20%	30%
General	2,50,000	2,50,001-5,00,000	5,00,001-10,00,000	10,00,001 & above
Senior Citizen (Resident & 60 years and above up to 79 years of age)	3,00,000	3,00,001-5,00,000	5,00,001-10,00,000	10,00,001 & above
Very Senior Citizen (Resident & 80 years and above of age)	5,00,000	–	5,00,001-10,00,000	10,00,001 & above

- Surcharge @ 10% of total tax if the total income exceeds ₹ 50 lakh but up to ₹ 1 crore.
- Surcharge @ 15% of total tax if the total income exceeds ₹ 1 crore.
- Health & Education Cess payable @ 4% of the total tax including surcharge.

Following are the Corporate Tax Rates applicable for Assessment Year 2020-21:

Category of Company	*Tax Rate*	*Total Income up to ₹ 1 Crore*		*Total Income > ₹ 1 Crore, < ₹ 10 Crore*		*Total Income > ₹ 10 Crore*	
		Surcharge	*Effective Tax Rate*	*Surcharge*	*Effective Tax Rate*	*Surcharge*	*Effective Tax Rate*
Domestic Co. with Turnover or gross receipts not exceeding ₹ 250 crores in FY 2017-18	25%	Nil	26%	7%	27.82%	12%	29.12%
New Domestic Manufacturing	25%	Nil	26%	7%	27.82%	12%	29.12%
Other Domestic	30%	Nil	31.20%	7%	33.38%	12%	29.12%
Foreign Company	40%	Nil	41.60%	2%	42.43%	5%	43.68%

- Health & Education Cess of 4% has been considered in determining the above tax rates.

Amidst the various pre-budget speculations about probable tampering of the Tax Slab Rates, the Interim Budget has continued with the tax rates, and maintained the basic exemption limit as the earlier financial year. However, in what is perhaps a minimal relief possible in the given scheme of things, and to add a pro middle-class flavour, an amendment has been proposed to Section 87A, wherein, it is now proposed to increase the rebate available to resident individuals.

Rebate

Under ***Clause 8*** of the Finance Bill, an amendment is proposed to ***Section 87A***. Under the existing provisions of Section 87A, a rebate of ₹ 2,500 is available to Resident Individuals whose total income does not exceed ₹ 3,50,000. It is now proposed to provide a rebate of

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₹ 12,500 in case of Resident Individuals whose total income does not exceed ₹ 5,00,000.

It is pertinent to note that such rebate is not available in respect of tax on Long Term Capital Gains u/s. 112A. Further, even if the incremental increase in tax on account of an incremental increase in income in excess of ₹ 5,00,000, is more than such incremental income, there is presently no provision of any Marginal Relief. By increase rebate and not increasing the maximum amount not chargeable to tax, even in case of assessee whose tax liability is NIL considering rebate, he is required to file return of income.

It is expected that provision of such proposed rebate is likely to affect approximately 30 million tax payers.

Amendments under the head "Income from House Property"

Clause 4 (considered here in part) *of the Finance Bill proposes an amendment to section 23(4) which relates to deemed income chargeable under the head "Income from House Property".*

Presently, an assessee is entitled to claim the Net Annual Value of a property as NIL, u/s. 23(2) in the following circumstances:

23(2)(a): is in the occupation of the owner for the purposes of his own residence; or

23(2)(b): cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him.

The benefit of adopting the Net Annual Value is presently available to the assessee in respect of any one property, which fulfils the above-mentioned criteria. In case the assessee is occupying more than one self-occupied property, notional income from such other property/ies is taxable u/s. 23(4).

Section 23(4) presently provides:

Where the property referred to in sub-section (2) consists of more than one house:

(a) The provision of that sub-section shall apply only in respect of one of such houses, which the assessee may, at his option, specify in this behalf:

(b) The annual value of the house or houses other than in respect of which the assessee has exercised an option under clause (a), shall be determined under sub-section (1) as if such house or houses has been let.

The Bill seeks to amend Section 23(4) to include two house properties, thereby extending the benefit of claiming the Net Annual Value as NIL in respect of two self-occupied properties.

Clause 5 *of the Bill proposes an amendment to* ***Section 24.***

The provisions of Section 24 relate to standard deduction and deduction in respect of Interest on loan availed for the purpose of purchase, construction, repairs, reconstruction and renewal of the house property. The proposed amendment is in connection with the restriction on deduction of interest for loan taken for self-occupied property.

First proviso to Section 24(b) states that for the property referred to in Section 23(2), the deduction of interest shall be restricted to ₹ 30,000 (For loan availed before 01-04-1999).

The second proviso to section 24(b) states that if the property referred to in Section 23(2) is purchased or constructed with loan availed on or after 01-04-1999, the deduction of interest shall be restricted to ₹ 2,00,000 (Subject to fulfilment of certain conditions).

The implication of this clause is further that the aggregate amount of interest claimed as deduction in respect of a self-occupied property, during the year cannot exceed ₹ 2,00,000.

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Clause 4 as discussed above seeks to amend Section 23(2) and to provide for Net Annual Value in respect of two self-occupied properties to be adopted as NIL.

Clause 5 proposes to amend Section 24(b), in rather a corresponding effect in the following manner:

The aggregate interest deductible in respect of **both** self-occupied properties shall be individually restricted to ₹ 30,000 (proposed amendment to the first proviso)

The aggregate interest deductible in respect of **both** self-occupied properties shall be individually restricted to ₹ 2,00,000. (subject to fulfilment of certain conditions)

After explanation to the third proviso, a new proviso is sought to be inserted: "Provided also that the aggregate of the amounts of deduction under the first and second proviso shall not exceed ₹ 2,00,000".

The implication being that even though the net annual value for two self-occupied properties can be adopted as NIL, the deduction in respect of interest, in case of interest paid or payable for both such properties shall be restricted to ₹ 2,00,000.

There are presently no amendments proposed to Section 71, and the restriction in set-off of loss under the head House Property against income from other head is capped at ₹ 2,00,000 under section 71(3A) which was introduced by Finance Act, 2017, w.e.f. A.Y. 2018-19.

Deduction under section 80C for principal repayment of housing loan component also remains unchanged, and should be available for both self-occupied properties.

The decision to not tax notional income from an additional self-occupied property is seen as a welcome move, both in terms of the benefit it shall provide to the property holders, as well as the impetus it shall provide to the real estate sector, which has been facing a slow down since some time now. This combined with the other amendments discussed in the ensuing paragraph emphasises that the interim budget, somewhere has an objective to boost up the real estate sector.

Talking of Individual property owners for now, this proposed amendment shall certainly be well received, and is likely to encourage those with the requisite purchasing power. However, it is interesting to note that maintaining the restriction on deduction of interest in aggregate for both the self-occupied properties shall perhaps have the effect of curtailing the full measure of benefit that could **have** been made available.

Clause 4 *(the other part) of the Bill further proposes to amend* ***Section 23(5).***

Sub-section (5) was inserted in section 23, by the Finance Act 2017, w.e.f. A.Y. 2018-19 which brought properties held as stock in trade under the ambit of the head "income from house property", subject to certain conditions.

Section 23(5) presently states:

Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and the property or part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period up to one year from the end of the financial year in which the certificate of completion of construction is obtained from the competent authority, shall be taken to be NIL.

This sub-section, inserted by the Finance Act 2017, sought to tax builders and developers in respect of the unsold inventory under the head Income from House Property. However, a window of one year is currently available wherein such property shall not be notionally taxed, if the same has not been actually let out. This period of one year is to be determined from the end of the financial year in which the completion certificate is received from the competent authority. In case such property is not sold post this period of one year, under existing provisions the builder/developer is liable to pay tax on notional income derived from the property.

The proposed amendment seeks to increase this period for which the net annual value is to be taken as nil to two years from the present one year. The implication being that unsold properties held as stock-in-trade, shall be taxed for notional income, only beyond a period of two years, from the end of the financial year in which the certificate of completion of construction is received. This amendment has been introduced to provide relief from the difficulties caused due to the earlier provision introduced by Finance Act, 2017 w.e.f. from AY 2018-19. Considering the principle of the interpretation and Apex Court decision in case of *Allied Motors (P.) Ltd.* vs. *CIT* (1997) 224 ITR 677(SC) a view cannot be ruled out that proposed beneficial amendment would also be effective from AY 2018-19 i.e. the date when original amendment was introduced.

Both the existing and proposed amendments elaborated herein, are in respect of such property/ies which have not been actually let out. So in a scenario, wherein a property held as stock in trade has been actually let-out, even before the expiry of one year under existing provisions (and two years under proposed amendment), actual rent received from such property shall be taxable.

The interim budget intends to do its bit for the real estate sector. There has been a lull in the real estate sector, almost from past two years. Statistics obtained from various property consultant websites point at an unsold inventory to the tune of 6-7 lakh in few cities alone. The rising prices and other regulatory constraints have been primarily responsible for the fall in demand in the sector.

An impetus to the real estate sector shall in-turn aid financial institutions which serve as a large source of funding to the sector. Thus. extending the period for approvals of affordable housing projects, (discussed in detail in "other amendments") extending the time period before notional income from unsold inventory becomes chargeable for the real estate developers coupled with extending the benefit to two self-occupied properties to individual assessees are measures that should encourage the real estate sector and pep up the demand.

"Amendment to Capital Gains"

***Clause 6** of the Bill seeks to amend **section 54** which deals with exemption of long-term capital gains arising from sale of residential house.*

Under the existing provisions, Capital Gains arising on transfer of a long term capital asset being residential house are exempt, if the same are reinvested in purchase or construction of another residential house in India.

The amendment seeks to insert a proviso which states as under:

"Provided that where the amount of capital gains does not exceed two crore rupees, the assessee, may at his option, purchase or construct two residential houses in India, and where such an option has been exercised,—

(a) The provisions of this sub-section shall have effect as if for the words "one residential house in India", the words "two residential houses in India" had been substituted;

(b) Any reference in this sub-section and sub-section (2) to "new asset" shall be construed as a reference to two residential houses in India.

This proposed amendment seeks to enable assessees to split their investments in two residential houses, and yet enjoy the tax exemption, in cases where the Capital Gains does not exceed ₹ 2 crore. This is particularly beneficial wherein ancestral property is subject matter of sale, and the sale proceeds are to be distributed among family members. The limit of ₹ 2 crore is irrespective of location of property i.e. urban/rural/semi-urban area.

It is to be noted that this proposed amendment is an option available to the assessee, and once the assessee chooses to exercise it for any assessment year, he cannot use it for the same or any other assessment year. Also, all other conditions of Section 54, subject to which the exemption under existing provision was available, continue to apply.

This proposed amendment has the ability to renew the existing questions & controversies surrounding the exemption u/s. 54, which could perhaps suffice as subject matter for another article!

Other Amendments

Clause 7 *of the Bill proposes to amend* ***section 80-IBA****, which contains provisions pertaining to deduction in respect of profits and gains from housing projects.*

This being an income linked deduction, is available in respect of affordable housing projects fulfilling requisite criteria, which are approved between the period 1st June 2016 to 31st March 2019. It is sought to extend the period for obtaining such approval by one year, and thus this section shall now be applicable for projects approved on or before 31st March 2020.

Clause 3 *of the Bill proposes an amendment to* ***Section 16(ia)*** *which is related to Standard Deduction available to Salaried Employees.*

It is proposed to increase the standard deduction from ₹ 40,000 to ₹ 50,000.

The Finance Act, 2018, had reintroduced the standard deduction u/s. 16, in its endeavour to provide some benefits to the Salaried employees, which predominantly comprises of the middle class, and one of the highest contributories in terms of collection of revenue. The interim budget raises this recently reintroduced standard deduction by a marginal amount of ₹ 10,000.

Clause 9 *of the Bill proposes an amendment to* ***Section 194A****, which relates to Tax deduction at source on Interest other than Interest on securities.*

Presently, interest paid or credited in aggregate up to an amount of ₹ 10,000 is tax-free, or in other words not liable for deduction of tax at source. This threshold for non-deduction is proposed to be raised to ₹ 40,000. Thus, interest up to ₹ 40,000 in aggregate in a year will now be received without TDS, under the proposed amendment. The most significant pay-out under Section 194A is interest on fixed deposits with Banks. An increase in the threshold for non-deduction implies that the recipient investors would now have less funds blocked as withholding tax.

Clause 10 *of the Bill proposes an amendment to* ***Section 194I****, which relates to Tax Deduction at source in case of Rent for use of property and assets.*

In the current scenario, amount of rent paid or credited, not exceeding an amount of ₹ 1,80,000 is not liable for deduction of tax at source. It is now proposed to raise this limit to ₹ 2,40,000. Thus, an amount of ₹ 2,40,000 would not be entitled to be received without any tax deducted at source.

The direct tax proposals of the interim budget, have garnered mixed response from various quarters, largely being termed as populist. All in all, they seem to target the middle-class income group, and give away some specific benefits for the real estate sector. As per statistics, the rebate for assessees having total income up to ₹ lakh is expected to benefit 30 million tax payers. Various news reports have quotes about the Interim Budget being a "trailer" of sorts, while the Interim Finance Minister clarified about their inability to make the full proposals they would have liked to in Income-tax, and that the Final Budget shall have all the proposals.

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Nonetheless, the interim budget, did pack a punch! Small though it may seem, the amendments, especially to Section 54 and Section 23(4) & 23(5) are capable of raising several questions and it would be interesting to note the same.

A summarised version of the existing provisions and the proposed amendments with their likely impact is annexed for easy reference.

As we brace for the general elections later this year, all eyes would be on the comprehensive Union Budget, anticipated to be presented in July 2019.

Summary on the Proposed Amendments of Finance Bill, 2019

Clause No.	*Section Ref:*	*Existing Provisions*	*Proposed Amendments*	*Effect/Impact*
Part 1		Rates of Tax	No change in the Income Tax Slabs, Tax Rates or Surcharge	–
Clause 3	Section 16(ia)	Standard Deduction of ₹ 40,000 is presently allowed to the assessee in computation of Income from Salary.	It is proposed to amend the section and increase the standard deduction to ₹ 50,000 from ₹ 40,000.	Marginal Relief to Salaried employees
Clause 4	Section 23(4)	The Net Annual Value of any one self occupied property, at the option of the assessee can be adopted as NIL. In case of more than one self-occupied property/ies, the same are to be treated as deemed to be let out properties	It is proposed to amend the section and extend the benefit of adopting the Net Annual Value as NIL to two self occupied properties. Thus deemed income u/s. 23(4) shall be computed only if assessee has more than two self occupied properties	Benefit to Individual assessees; Amendment may boost demand in real estate sector
Clause 4	Section 23(5)	Deemed income from property held as stock-in-trade is made taxable under Income from House Property. However, if such property or part thereof, has not been let out during whole or part of the	Under the proposed amendment, this period of one year in which the Net Annual Value is to be adopted as NIL, is to be extended to two years, other conditions remaining constant	Benefit to Developers

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Clause No.	*Section Ref:*	*Existing Provisions*	*Proposed Amendments*	*Effect/Impact*
		previous year, then for a period of up to one year from the end of the financial year in which the completion of construction certificate is obtained from competent authority, the Net Annual Value shall be adopted as NIL		
Clause 5	Section 24	The section restricts the interest deduction in respect of self occupied property to ₹ 30,000/₹ 2,00,000	Under proposed amendment as per clause (4) to Section 23(4), the deemed income is now taxable for more than two self occupied properties. This amendment clarifies that even though the benefit of adopting NAV as NIL has been extended to two self occupied properties, the restriction for deduction of Interest at the existing amounts is for both such self occupied properties	Effect of curtailing the benefit made available to Individual assessees by above amendment in Clause 4
Clause 6	Section 54	This section provides exemption in respect of Capital Gains arising on sale of a long term capital assets being a residential house, provided such gain is utilised	The amendment seeks to insert a proviso, and in cases where the amount of Capital Gains does not exceed ₹ 2 crore, it gives assessee the option to construct/purchase	Split in utilisation of Capital Gains, should benefit individual assessees in specific circumstances

Clause No.	***Section Ref:***	***Existing Provisions***	***Proposed Amendments***	***Effect/Impact***
		in purchase/ construction of another residential house in India, within the stipulated period	two residential houses in India, all other conditions remaining the same Reference to New Asset in the section to be construed as reference to both the residential houses. However, once the assessee claims the exemption in respect of two residential properties, under this proviso, he shall subsequently not be entitled to exercise the option for the same or any other assessment year	
Clause 7	Section 80-IBA	This section deals with deductions in respect of profits and gains from housing projects. Under the existing section, the project to qualify for deduction, among other conditions had to be approved after 1st June 2016, but on or before 31st March 2019	The amendment proposed to this section seeks to increase the period for obtaining the approval by one year, and thus the extension in time period for obtaining approval from March 2019 to March 2020	Extension for obtaining approval for affordable housing projects
Clause 8	Section 87A	The rebate under this section was ₹ 2,500 for resident individuals whose total income did not exceed ₹ 3,50,000	Under the proposed amendment, the rebate is to be increased to ₹ 12,500 for resident individuals whose	Relief to assessees having total income up to ₹ 5 lakhs

Clause No.	*Section Ref:*	*Existing Provisions*	*Proposed Amendments*	*Effect/Impact*
			total income does not exceed ₹ 5,00,000	
Clause 9	Section 194A	Interest paid or credited in aggregate, not exceeding ₹ 10,000 is not liable for deduction of TDS under the existing provisions	It is proposed to increase this threshold for non deduction of TDS on such interest from ₹ 10,000 to ₹ 40,000. Therefore, now interest paid or credited in aggregate, not exceeding ₹ 40,000 is not liable for deduction of TDS	–
Clause 10	Section 194I	Rent paid or credited in aggregate, not exceeding ₹ 1,80,000 is not liable for deduction of TDS under the existing provisions	It is proposed to increase this threshold for non-deduction of TDS on such rent from ₹ 1,80,000 to ₹ 2,40,000. Therefore, now rent paid or credited in aggregate not exceeding ₹ 2,40,000 is not liable for deduction of TDS	–

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Do all as a sacrifice or offering to the Lord. Be in the world, but not of it, like the lotus leaf whose roots are in the mud but which remains always pure. Let your love go to all, whatever they do to you. A blind man cannot see colour, so how can we see evil unless it is in us?

— *Swami Vivekananda*


CA Milan Mody & CA Ramesh Ramakrishnan

In Focus – Accounting and Auditing

SA 230: Audit Documentation: If it is not documented, it is not done

Why is audit documentation need of the hour?

Consequent to the recent unearthing of major scams in large corporates, questions are being raised on the professional standards, quality and independence of the Chartered Accountants. This has led to rise of allegations which has tarnished the image of the profession in the eyes of corporates and the stakeholders. Chartered Accountants take due care while discharging their professional obligations but often face the challenge of displaying the same through appropriate documentation. Purpose of audit documentation is twofold; it must serve as an evidence for basis of auditor's conclusion on achievement of overall objectives of an audit and as an evidence that audit was planned and performed in accordance with SAs and applicable legal and regulatory framework.

Governing bodies and regulatory requirements pertaining to audit documentation.

Peer Review

The Institute of Chartered Accountants of India (ICAI) has formulated 'Peer Review Board' to ensure that members of the Institute comply with all technical standards while performing engagements and to ensure that proper systems (including documentation) are in place for maintaining quality of the service provided by them. Audit documentation is very relevant for satisfying the requirements of the peer reviewer.

Quality Review Board (QRB)

QRB is established by the Government of India, aims to improve the quality of the audit firms by reviewing the engagements and highlighting lapses which requires corrective actions to be taken. It focuses on various parameters including documentation as one of the major criterion to evaluate the quality of engagement. As per QRB report 2017-18, non-compliances with respect to SA 230 'Audit Documentation' to an extent of 15% of the total audit engagements under review were reported.

The Companies Act, 2013

Section 149(9) of The Companies Act, 2013 states that every auditor shall comply with the auditing standards. It is in turn a requirement under various standards to maintain documents at different stages to prove that the audit work was performed in compliance with the professional standards. Additionally, various claims against the auditor for negligence can be addressed only by ensuring a well-defined audit procedure and proper documentation of the same.

Standards on Auditing (SA)

SA 230 focuses on audit documentation required at various stages right from planning to issuing report. It provides guidance on:

- Form and content of documentation,
- Factors affecting form and content,
- Retention period of minimum seven years,
- Ownership of working papers etc.

The documentation requirement is not confined to SA 230 alone; the significance of audit documentation is so extensive that other auditing standards have specific documentation requirement embedded in their text. The topics on which the document requirements is extremely relevant are as (a) Planning (b) Performance/ execution and (c) Reporting/ conclusion.

(For an exhaustive list of documentation requirements on the above standards, refer Appendix-I)

Common misconceptions with respect to audit documentation

Audit documentation is how an auditor can prove to others that work has been executed in reasonable manner. Despite audit documentation being an important part of the audit engagement, auditors often question whether the effort of sufficient documentation is worth the end result. There are often lots of misconceptions revolving around this subject among which some of common ones are:

1. **Auditor can meet their audit objective without documenting their work**
   Auditor cannot complete an audit without appropriate documentation. If sufficient appropriate audit evidence necessary to support the audit opinion was not appropriately documented, then the audit was not conducted in accordance with SAs and the auditor would not have a basis to render an opinion.

2. **Deficiency can be dealt with at a later stage when pointed out by a reviewer**
   The individual who performs the work is the owner of that work and must take personal responsibility for it. If it doesn't make sense to the owner, it will not make sense to anybody else. It is critical to explain and document the work in one's own words in order to understand and connect the dots.

3. **Documentation of process which are generic/ easily understandable is not required**
   It is essential to document the work performed and conclusions reached in the audit working papers in detail. Well-documented work papers improve quality of the audit and create assets for both present and future audits. New team members on recurring clients can utilize past documentation to improve the efficiency of future analyses.

4. **A sign off on a detailed audit programme is a substitute for documentation of a detailed test**
   A sign off on detailed audit programme is not sufficient to meet the documentation requirements of the engagement. It addresses only documentation with respect to details of the nature of the process and establishing who performed the process and who reviewed it. Supporting working papers are necessary for ensuring completeness in documentation.

5. **Verbal explanation is sufficient**
   Verbal explanation cannot be substantiated as an evidence that is necessary to support an audit opinion.

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6. **A Letter of Representation (LOR) is a substitute for detailed verification and documentation**
   As elaborated in SA 580 'Written Representation', LOR is not a substitute for auditor's responsibility for planning and executing an effective audit. The purpose of LOR is limited to the extent of providing necessary audit evidence and not a sufficient appropriate audit evidence nor a substitute to audit documentation.

7. **SA 230 is not applicable while conducting tax audits / audit of non-corporate entities**
   The members are required to follow the auditing standards and thereby it is mandatory to comply with the documentation standard while issuing audit report under Income-tax Act also. Similarly any report issued for non-corporate entity would have also have to comply with SA 230

8. **Time management is more critical and relevant than audit documentation:**
   Quality of work should never be sacrificed for the sake of time. To improve audit efficiency, auditor is required to keep an open mind with regard to audit methodology, and allocate time effectively in order of priority. Allocation of time for documentation is as important as allocating time for performance of actual process.

Professionals should not fall victim to the above traps and misconceptions. The information contained in work papers, and audit files are the principal record of the work performed, conclusions reached and the opinion expressed. Without the words, the numbers sit oddly and perhaps dangerously silent.

FAQs for audit documentation provided in revised implementation guide on SA 230

The Revised Implementation Guide (IG) on Standards on Auditing (SA) 230 'Audit Documentation' has been issued by the Institute of Chartered Accountants of India (ICAI) on 3rd December 2018 to assist the auditors to understand the requirements of the standards and provide a practical guide to the auditors in implementing the standards.

The revised IG contains 37 FAQs some of the key questions and the solution provided in IG are summarised as follows:

Sr. No.	Issues addressed through FAQs	Summary of solutions provided in IG
1	What are the purposes which may be served by audit documentation?	Besides normal benefits as discussed above, it enables external inspections in accordance with applicable legal and regulatory framework
2	What should not be included in audit documentation?	Minutes book, records, bills, fixed asset register etc. which are nature of management records and documents which are duplicate/ incomplete should not be included in audit documentation. On the contrary abstract of management records with checking notes can be kept as working paper.
3	Relevance of balance confirmation and whether the same is required for all accounts	Not required for all account balances. It Depends on size and volume. Judgment to be used as regards possibility of fraud or error while deciding the quantum.

Sr. No.	Issues addressed through FAQs	Summary of solutions provided in IG
4	Requirement for reporting all non-compliances in relation to laws/regulations.	Auditors are expected to disclose the material non-compliances for high quality reporting. Further, they are expected to maintain document to support disclosure requirement as per applicable financial reporting framework.
5	Documentation requirement when it is necessary to depart from the requirements in SA?	Reasons for such departure and alternate audit procedures performed needs to be documented
6	By when should an auditor complete the process of assembling the final audit file and what are the changes permissible post assembly?	Audit file should be assembled on timely basis post the issue of audit report (appropriate time limit should not be more than 60 days from audit report). Changes are permissible if they are administrative in nature post assembly (e.g. deleting/discarding superseded documents, cross references etc.)

Audit documentation for Small and Medium Size Entity (SME)

Small audits have their own set of challenges, such as limited internal controls with the possibility of management override, or less sophisticated systems. Such engagements are required to be performed with appropriate quality and at a lower cost. From the auditor's perspective, there is a difference in level of risk in small as compared to risk associated with large audit. For instance, large clients carry higher engagement risk, but this is mitigated to some extent by a well-developed internal control structure in place.

As per the IG, smaller and less complex entities are less extensive as compared to that of a larger entity. The IG throws light on following points with regards to such engagements:

1. There may be more undocumented communication and only letter of representation may be available as formal documentation.
2. It may be efficient to record various aspect of audit in a single audit document for SME clients.
3. IG goes on further to explain specific consideration in SAs for SME clients:

Specific considerations in SAs
SA 260 (R) explains that in some cases the auditor may need to discuss and agree with the client the relevant person with whom to communicate.
SA 265, deals with control environment in case of SMEs and the interplay of the same on audit engagement
SA 240, in case where single owner manages the entity no action on the part of the auditor is warranted as there is no oversight separate from that of the management.
SA 300, elaborates the relaxation which the auditor can take while auditing SME in terms of audit planning and strategy.
SA 315 explains the situation when engagement partner is directly involved in audit and the difficulty in applying analytical procedures.
SA 320 on materiality deals with situation where major portion of profit is taken by the owner as remuneration, benchmark of such profit is relevant for audit documentation.
In the case of SMEs, there may not be many control activities that could be identified by the auditor, or the extent to which their

existence or operation have been documented by the entity may be limited as explained in SA 350.
SA 570 (R) explains the indicators which auditor should use while evaluating the going concern issue in case of an SME in financial difficulty.

In a nutshell, small businesses tend to have peculiar characteristics that may call for a distinct approach. Possible challenges that a practitioner may face include:

1. Fewer financial controls (e.g., unable to segregate duties),
2. Lower capacity to "close the books" (i.e. accuracy of accruals and provisions),
3. More related party transactions,
4. May be subject to some complex taxation requirements etc.

The practitioners need to assess the peculiarity of the client and perform a cost benefit analysis for documenting relevant working papers while performing an audit of SME client.

Audit documentation in case of Small and Medium sized Practitioners (SMP)

SMPs have a challenge of performing a quality audits with relatively limited fees. Documentation of SMP may be subject to various downfalls such as:

- Inadequate client and firm level bandwidth,
- Rotation of team not possible,
- Absence of QC process,
- Higher reliance on oral documentation and
- No use of standard checklist and audit tools etc.

Due to the above constrains, SMPs shall require to focus on standardising the documentation process by training the team to maintain necessary and relevant documentation, prepare a standard firm level checklist, focus on most important and relevant items, internal checks for quality control, etc.

Practical tips on audit documentation

Set aside specific time for documentation and review

While preparing a detailed audit plan it is necessary to set aside a designated time period and fix responsibility on an audit team member to maintain quality audit working paper and prepare an audit file.

Document what is relevant

Retrieval of correct and relevant document is as important as documentation. Rather than dumping all the papers it is important that key documents are indexed, cross referenced for easy accessibility at a later date.

Bring in standardisation

Following would help in bringing uniformity

- Standardised working paper format at firm level
- Standard audit flaps/ dividers in hard and soft copy
- Firm level policy for version control and labelling of files
- Format of representation letter

Document on the go

Documentation is more likely to be accurate if it is performed sooner rather than later as the preparer is not required to remember vast amounts of information or to repeat tasks after the procedure is performed if the documentation for the process is completed.

Use smart and customised checklists

Use of customised checklist can help the auditors to focus on appropriate compliance

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required exclusive for their clientele. The use of generic checklists would not serve the purpose of quality documentation as the user will end up filling exhaustive checklists even for smaller clients. This may lead to the whole process being redundant and just a meaningless formality.

Preparing an audit file which is complete in all respects

- Index for documents in soft and hard copy
- Ensuring that the final version of documents is identifiable
- Maintaining of Permanent audit file (PAF) for each client
- Cold review by external person
- Sign off and checklist to ensure all important documentation aspect is taken care of

Final audit file should serve as a ready reference for subsequent audit period and the user should be able to locate relevant document in reasonable time as and when needed.

Use of audit documentation tools for document management and retrieval

As the technology advanced, opportunities have emerged for gaining efficiency and improved management over audit documentation electronically. Following are few advantages of using audit documentation tools:

- Improved performance,
- Standardisation,
- Elimination of human error,
- Availability of visual statistics and
- Saves time.

By use of various auditing tools and software packages for documentation, auditor can ensure that the necessary working papers are captured as and when audit procedures are performed. This is subject to cost benefit analysis as spending on audit tools could be an expensive and lengthy proposition.

To sum it up

It a well-accepted fact that audit and documentation are inseparable. A well-documented audit file shows firm's robust internal process and its commitment towards a well governed audit. It is imperative under the Companies Act and professional standards to maintain appropriate documentation. It not only saves auditor from any future exposure but also acts as a guide for new team members.

The Audit file should be self-explanatory and capable of demonstrating the audit steps and due care taken by the Auditor. It is like a mirror which shows the reflection of the quality of work performed.

Appendix

Appendix I: Documentation requirements under various standards

Documentation requirements at planning stage:	
1.	**SA 210: 'Agreeing to the terms of audit engagement':** Form and content of the engagement letter and emphasises that the same should be an exhaustive document covering the detailed scope (inclusions and exclusions).
2.	**SA 220: 'Quality Control for an audit of financial statement':** • Procedure adopted to reach at the audit conclusion. • Confirmation of independence for client continuance • Issues identified with respect to compliance of ethical standards and how resolved

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3.	**SA 240: 'The Auditor's responsibilities relating to fraud in an audit of financial statements'** • Auditor's response to assessed risk • Communications with the management • Indicators that led to detection of fraud
4.	**SA 250: 'Considerations of Laws and Regulations in an Audit of Financial Statement'** • Auditor is required to document the identified or suspected non-compliances • Discussion with the management regarding the same.
5.	**SA 260 (R): 'Communication with those charged with Governance'** • Matter communicated • When and to whom communication was made • Minutes of meeting (in case of verbal communication)
6.	**SA 265: 'Communicating deficiencies in internal control to those charged with governance and management'** • Deficiencies communicated to management and receipt of such communication.
7.	**SA 300: 'Planning an audit of financial statement'** • Overall audit plan and audit strategy • Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.
8.	**SA 315: 'Identifying and assessing the risk of material misstatement through understanding the Entity and its Environment'** • Organisational business processes • Risk associated with the entity with respect to above process • Considerations required to address the above risks
9.	**SA 320: 'Materiality in planning and performing audit'** • Materiality at Financial statement level • Performance materiality, and • Revision in materiality as audit progresses
10.	**SA 330: 'Auditor's response to assessed risk'** • Extent of auditor procedure to be performed to address the assessed risk & the time required • Final conclusions reached
Documentation requirements at performance/ execution stage	
11.	**SA 402: 'Audit considerations relating to an Entity using service organisation'** • Control evaluation of the service organisation using Type 1 and Type 2 report.
12.	**SA 505: 'External Confirmation'** • Details of confirmations sent • Results of external confirmation
13.	**SA 510: 'Analytical Procedure'** • Results arrived from various analytical procedures.
14.	**SA 530: 'Audit Sampling'** • Sample design • Basis for selection of samples • Evaluation and results of sampling.

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15.	**SA 540: 'Auditing accounting estimates including fair value estimates and related disclosures':** • Auditor's conclusion regarding the reasonableness of accounting estimate • Disclosure of significant risks
16.	**SA 570 (R): 'Going Concern':** • Any significant risk or event that may affect the entity to continue as a going concern • Auditor's conclusion and judgement
17.	**SA 600 and SA 610 (R): 'Using the work of another auditor' and 'Using the work of internal auditors':** • Scope, competency of component/internal auditor • How work of the component/internal auditor affects the work of principal/statutory auditor.
Documentation requirements at reporting/ conclusion stage	
18.	**SA 450: 'Evaluation of misstatement identified during the audit':** • List of misstatement identified during the audit • How the same was addressed by the management • Its impact on the financial statements.
19.	**SA 700 (R): 'Forming an opinion and reporting on financial statements':** • Basis of forming an opinion on financial statement (Modified/ Emphasis of matter)
20.	**SA 701: 'Communicating Key Audit matters in the independent auditor's report'** • Rationale of deciding why the matter should be included under key audit matter • Basis of determination of the above matters and relevant judgement of the auditor
21.	**SA 720 (R): 'Auditor's responsibilities relating to other information'** • Procedures performed under the SAs • Final version of the other information on which the auditor has performed work.
22.	**Other engagements** With respect to standards relating to engagements other than those involving forming an opinion on the financial statements, viz. Standard on Review of Engagements (SREs), Standard on Assurance Engagements (SAEs), Standards on related services (SRSs) specific documentation requirements are covered in the relevant texts, broadly it covers documentation with respect to following matters: • Nature, timing & extent of audit procedure, • Basis of conclusion, • Significant matters and conclusions reached thereon and • Who performed the procedures, who reviewed along with the date of completion, etc.
Also guidance note on 'Reports or Certificates for Special Purposes' requires a practitioner to maintain appropriate documentation.	

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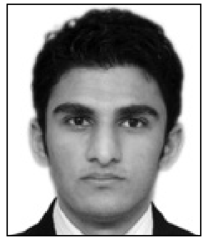

Rahul Sarda, *Advocate*

Best of the Rest

Facebook friendship between a judge and an attorney – Whether sufficient disqualification for the judge to hear a case?

A motion was filed for disqualification of a trial judge on the basis that the judge was a "Facebook friend" with an attorney appearing before him. There were conflicting Court decisions on the issue and hence Supreme Court of Florida decided the issue.

The Supreme Court of Florida discussed the issue thus: In the traditional sense, a "friend" was a person attached to another person by feelings of affection or esteem or as one that seeks the society or welfare of another whom he holds in affection, respect, or esteem. But "friendship" in the traditional sense of the word did not necessarily signify a close relationship. It is commonly understood that friendship existed on a broad spectrum: some friendships were close while others were not.

Mere existence of a friendship between a judge and an attorney appearing before the judge, did not reasonably convey to others the impression of an inherently close or intimate relationship. No reasonably prudent person would fear that he could not receive a fair and impartial trial based solely on the fact that a judge and an attorney appearing before the judge are friends of an indeterminate nature.

On Facebook, a user can establish connections with other Facebook users by 'friending' them; the connected users are thus called "friends". It could be said that a Facebook user publicly "communicates" the existence of the user's Facebook "friendships" to others. In its most basic sense, a Facebook "friend" is a person digitally connected to another person by virtue of their Facebook "friendship". A Facebook "friend" may or may not be a "friend" in the traditional sense of the word. But Facebook "friendship" was not the functional equivalent of traditional "friendship". The establishment of a Facebook "friendship" did not objectively signal the existence of the affection and esteem involved in a traditional "friendship." The Court observed that today it is commonly understood that Facebook "friendship" exists on an even broader spectrum than traditional "friendship". Traditional "friendship" varies in degree from greatest intimacy to casual acquaintance; Facebook "friendship" varies in degree from greatest intimacy to "virtual stranger" or "complete stranger". Since the creation of a Facebook "friendship" in itself did not signal the existence of a traditional "friendship", it certainly could not signal the existence of a close or intimate relationship.

Thus, it was held that existence of a Facebook friendship between a judge and an attorney

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appearing before him was not a sufficient basis for disqualification of the judge.

Law Offices of Herssein and Herssein, P.A., etc., et al., vs. United Services Automobile Association, SC17 – 1848 dated 15th November 2018 - Supreme Court of Florida.

Former employee – Whether disqualified from acting as arbitrator – Amendment of 2015 considered?

During the execution of an agreement, disputes arose between the parties and the Respondent issued notice to Indian Council of Arbitration (ICA) requesting ICA to commence arbitration proceedings. The Appellant-State nominated a retired Engineer-in-Chief as their nominee arbitrator to which the Respondent objected on the ground that the arbitrator nominated by the Appellant-State that he was a retired employee of the State, and there may be justifiable doubts with respect to his integrity and impartiality to act as an arbitrator. The Appellant-State refuted the objection on the ground that the nominee arbitrator was a Chief Engineer who retired over 10 years ago from the services of the State and the apprehension of the Respondent was unjustified since the test to be applied for bias is whether the circumstances are such as would lead to a fair-minded and informed person to conclude that the arbitrator was in fact biased.

Held that the Arbitration and Conciliation Act, 1996 did not disqualify a former employee from acting as an arbitrator, provided that there are no justifiable doubts as to his independence and impartiality. Though the present case was governed by the pre-amended Arbitration and Conciliation Act, 1996, the Supreme Court also discussed the amendment of 2015 which contains grounds to determine whether circumstances exist which give rise to justifiable doubts as to the independence or impartiality of an arbitrator. Held that a person, who is related to a party as an employee, consultant, or an advisor, is disqualified to act as an arbitrator. The words "is an" [Relevant provision for disqualification being - The Arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party] indicates that the person so nominated is only disqualified if he/she is a present/current employee, consultant, or advisor of one of the parties. An arbitrator who had "any other" past or present "business relationship" with the party was also disqualified. The word "other" would indicate a relationship other than an employee, consultant or an advisor. The word "other" could not be used to widen the scope of the entry to include past/former employees. Hence, held that former employees could be appointed as arbitrators to adjudicate on disputes of their erstwhile employers.

It is important to note that in this case, during the course of arguments, both parties mutually agreed to the arbitration being conducted by a Sole Arbitrator in supersession of the arbitration Clause in the agreement which provided for a three-member arbitration panel and hence, the Supreme Court appointed a retired Judge of the Supreme Court as the Sole Arbitrator.

Government of Haryana, PWD Haryana (B and R) branch vs. M/s. G. F. Toll Road Pvt. Ltd. & Ors. dated 3rd January 2019 – Supreme Court of India

Whether the Trial Court which had admitted the agreements to sell in evidence could have exercised its discretion in imposing penalty?

In a suit for specific performance, the Principal Civil Judge impounded agreement to sell filed by the plaintiff in the suit on account of insufficiency of with the direction to the Plaintiff to pay deficit duty and penalty. The Plaintiff thereafter challenged the order by way of a Writ Petition which was disposed of by the

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High Court directing and permitting the trial judge to let the Plaintiffs place their written submissions. Accordingly, the agreements to sell were admitted in evidence and marked for the Plaintiffs by the trial judge. Further, the deficit stamp duty along with double amount of deficit duty was determined as penalty on the insufficiently stamped documents. Being aggrieved by the order, the Respondent filed a Writ Petition in the High Court which directed Trial Court to levy the penalty at 10 times of the amount deficit duty. Aggrieved by the said order, the Appellant filed the present appeal before the Supreme Court.

Held, according to Section 33 of Karnataka Stamp Act, 1957, every person having by law or by consent of parties, authority to receive evidence, is obliged to impound any instrument which according to him is not duly stamped and the statute envisages that when the 10 times of the amount of the proper duty or deficient portion thereof exceeds five rupees, a sum equal to 10 times of such duty or portion is the penalty which is a flat rate penalty.

Whereas, Section 34 of the Act provides that instruments not duly stamped are inadmissible in evidence, Section 38 empowers the Deputy Commissioner to refund penalty paid under section 37(1). Section 39 deals with the power of Deputy Commissioner to impound the documents insufficiently stamped. However, Section 34 proviso provides for admitting in evidence an instrument not duly stamped on payment of duty and penalty. The Deputy Commissioner has discretion of imposing penalty lesser than 10 times of the amount of duty or portion thereof.

Further held that the High Court had correctly interpreted the provisions requiring levy of penalty of 10 times, and even though 10 times penalty has to be collected and imposed by the person impounding the document, the Trial Court imposing the penalty at the rate 2 times has recorded its reason stating that the agreements are prepared by the local villages who are not experienced in documentation and looking at the status of the Plaintiff levying 10 times penalty in respect of the said agreement would be harsh and levying double the amount of deficit duty will meet the ends of justice.

Therefore, instead of directing the Appellant to pay the penalty of 10 times and then permitting it to approach the Deputy Commissioner, the Supreme Court held that payment of deficit duty double penalty as imposed by the trial court would meet the ends of justice.

Gangappa and Anr. vs. Fakkirappa, Civil Appeal No. 11932 of 2018 dated 14th December 2018 - Supreme Court.

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th January, 2019 to 7th February, 2019 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1. The following new members were admitted to the Managing Council Meeting held on 16th January, 2019.

Life Membership			
1	Mr. Parekh Mrunal Jayant	Adv.	Mumbai
2	Mr. Tata Krishna J.	Adv.	Bengaluru
3	Mr. Chythanya K. K.	Adv.	Bengaluru
Ordinary Membership			
1	Mr. Atal Mahavir Anil	CA	Nagpur
2	Ms. Phanse Vidya Shivram	CA	Mumbai
3	Mr. Kimbahune Ameet Avinash	CA	Mumbai
4	Mr. Malpathak Rajiv Jagadish	CA	Nashik
Student Membership			
1	Mr. Sultaniya Gunjan Kumar	ICAI	Kolkata

II. PAST PROGRAMMES

1. DIRECT TAXES COMMITTEE

A Lecture meeting on TDS Procedures covering Issues on Processing by CPC was held on 29th January, 2019 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate. The Lecture Meeting was addressed by Ms. Anuradha Bhatia, Principal Chief CIT (TDS), Mumbai, Mr. V. K. Gupta, CIT (TDS) Mumbai; Mr. Pratap Singh, CIT (TDS), Mumbai, Mr. Sunil Sharma, CIT CPC, Ghaziabad Mr. Saurabh Arora, ITO-CPC (TDS) and Mr. K. R. Narayana, Jt. Director, CPC & e-Filing. The meeting received an overwhelming response from the members.

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2. INDIRECT TAXES COMMITTEE

- The 7th Residential Refresher Course on GST was held from 24th to 27th January, 2019 at Hotel Novotel, Hitec City, Hyderabad. The course was addressed by Mr. K. Vaitheeswaran, Advocate, CA Pratik Jain, Mr. Nishant Shah, Advocate and CA Jayraj Sheth. Mr. A. R. Krishnan was the moderator for the panel discussion for which Mr. Simachal Mohanty, Advocate, Mr. Nishit Shah, CA Jayraj Sheth, Mr. K. Vaitheeswaran, Advocate and CA Pratik Jain were the panellists. The RRC received an overwhelming response from 214 members.
- A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC of ICAI was held on 17th and 30th January, 2019 at GSTPAM, Mazgaon Library, 1st Floor, Vikrikar Bhavan, Mazgaon. The workshop was addressed by CA Rajat Talati, CA Jayesh Gogri, CA Aditya Surte and CA Manish Gadia.

3. MEMBERSHIP & PR COMMITTEE

The CTC Box Cricket Tournament was held on 12th January, 2019 at Dr. Antonio D'Silva School Turf, S. K. Bole Road, Opp. Kabutar Khana, Dadar (W), Mumbai-400 028. The tournament received an overwhelming response. 36 teams participated out of which 6 were girls' team. The winners were as below:

"Winning Team" from Deloitte India LLP (Boys Team)

"Man of the Series" Mr. Harsh Anand from Deloitte India LLP

"Best Batsman" – Mr. Zaid Kadiwal from Deloitte India LLP

"Best Bowler" - Mr. Rohit Kataria from T. P. Ostwal & Associates LLP

"Runner up" from Ernst & Young LLP

"2nd Runner up" from BDO India LLP

"Winning Team" BDO India LLP (Girls Team)

"Woman of the Series" Ms. Diksha Raina from BDO India LLP

"Best Batswoman" Ms. Diksha Raina from BDO India LLP

"Best Bowler" Ms. Swati Lahoty from BDO India LLP

"Runner up Team" from PWC India

4. RRC & SD COMMITTEE

"Surila Yaarana" A Musical Evening was held on 11th January, 2019 at Club W-Ballroom, Level P-6, Lodha World Tower, Lower Parel. CTC members attended the event along with their families and friends. The music was arranged by the famous musicians "Bamboo Beats" whose singers also enthralled the audience with their rendering of regional folk songs.

5. STUDENT COMMITTEE

The Chamber's Debate Competition was held on 18th & 19th January, 2019 at H. R. College of Commerce & Economics, Churchgate. Colleges and firms all over Mumbai had participated in the Debate Competition with great enthusiasm.

Judges for final round were Hon'ble Mr. G. S. Pannu (Vice-President, ITAT Mumbai), Mr. Arvind Sonde, Advocate and Mr. Percy Pardiwalla, Senior Advocate.

The winners were as below:

Winning Team – Nari Gursahani Law College

1st Runner up Team – M. B. Nayak & Co.

2nd Runner up Team – Hinesh. R. Doshi & Co., LLP

Best Speaker – Ms. Sparsh Khanchandani, Nari Gursahani Law College

III. FUTURE PROGRAMMES

1. DIRECT TAXES COMMITTEE

- A Study Course on Interpretation of Taxing Statutes is scheduled to be held on 16th, 22nd and 23rd February, 2019 at Babhubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate.
- A Non-Residential Refresher Course on Direct Tax (Case Study based Approach) is scheduled to be held on 15th & 16th March, 2019 at Jai Hind College, AV Room, 4th Floor, Churchgate.

2. INDIRECT TAXES COMMITTEE

A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC of ICAI is scheduled from 17th January, 2019 to 14th March, 2019 at GSTPAM, Mazgaon Library, 1st Floor, Vikrikar Bhavan, Mazgaon-400 010.

3. INTERNATIONAL TAXATION COMMITTEE

- The 13th Residential Refresher Course on International Taxation, 2019 is scheduled to be held from 20th June, 2019 to 23rd June, 2019 at The Grand Bhagwati, Surat.
- The 5th International Study Tour is scheduled to be held from 25th May, 2019 to 5th June, 2019 at Central Europe.

4. IT CONNECT COMMITTEE

A Half day Workshop on IT Security in Tax Consultants Office is scheduled to be held on 22nd February, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate.

5. MEMBERSHIP & PR COMMITTEE

A Lecture Meeting on "Life is Beautiful" by Pujya Saint Gyanvatsaldasji is scheduled to be held on 8th March, 2019 at Babhubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate.

6. RESIDENTIAL REFRESHER COURSE & SKILL DEVELOPMENT COMMITTEE

The 42nd Residential Refresher Course is scheduled to be held from 28th February, 2019 to 3rd March, 2019 at Hotel Ramada, Hyderabad.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of February, 2019).

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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.

Study Circle & Study Group Committee

SC on Provisions relating to Revision Proceedings before CIT(A) & Misc. Petition before ITAT and issues therein was held on 10th January, 2019 at Kilachand Hall, 2nd Floor, IMC

Mr. Amar Ghalot
Advocate addressing
the delegates

SG on Recent Judgments was held on 17th January, 2019 at Babubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate

CA Anish Thacker
addressing the delegates

CA Dwani Shah
addressing the delegates

Direct Taxes Committee

Webinar on Stay of Demand under Income-tax Act, 1961 was held on 19th January, 2019

CA Jhankhana Thakkar
addressing the delegates

ISG on Recent Case Laws was held on 21st January, 2019 at CTC Conference Room

CA Ketan Vajani
addressing the delegates

International Taxation Committee

FEMA SC on Issues in reporting under FEMA: FDI was held on 24th January, 2019 at CTC Conference Room

CA Isha Shekri
addressing the participants

Indirect Taxes Committee

IDT SC on Important Advance Rulings and High Court decisions in GST was held on 15th January, 2019 at Jai Hind College, AV Room, 4th Floor, Churchgate

Mr. Ratan Samal,
Advocate addressing
the delegates

Mr. Vinay Jain,
Advocate addressing
the delegates

Live screening of Budget, 2019 at CTC Office

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Indirect Taxes Committee

7th RRC on GST was held from 24th January, 2019 to 27th January, 2019 at Novotel Hotel, Hyderabad

Chief Guest Mr. Devendra Surana (MD - Bhagyanagar India Ltd.) inaugurated the Course. Seen from L to R: S/ Shri Mr. K. Vaitheeswaran, Advocate (Speaker), CA Hinesh R. Doshi (President), CA A. R. Krishnan (Advisor) and CA Naresh Sheth (Chairman)

Dignitaries at the inauguration session. Seen from L to R: S/Shri CA Hemang Shah (Convenor), CA Sumit Jhunjhunwala (Convenor), CA Vikram Mehta (Past Chairman), CA Avinash Lalwani (Past President), Mr. K. Vaitheeswaran, Advocate (Speaker), CA Atul Mehta (Vice-Chairman), Chief Guest Mr. Devendra Surana, (Chief Guest); CA Hinesh R. Doshi (President), CA A. R. Krishnan (Advisor), CA Naresh Sheth (Chairman), CA Pranav Kapadia (Member), CA Rajiv Luthia (Member) and CA Kush Vora (Convenor)

CA Hinesh R. Doshi (President) giving his opening remarks.

CA A. R. Krishnan (Advisor) welcoming the delegates. Seen from L to R: S/ Shri CA Atul Mehta (Vice-Chairman, Mr. Devendra Surana, (Chief Guest); CA Hinesh R. Doshi (President), CA Naresh Sheth (Chairman) and CA Sumit Jhunjhunwala (Convenor)

Mr. Devendra Surana (MD - Bhagyanagar India Ltd.) delivering keynote address

Dignitaries on dais Seen from L to R: S/ Shri CA Hemang Shah (Convenor), CA Pratik Jain (Speaker), CA Vipul Choksi (Vice-President), Mr. S. Thirumalai, Advocate (Chairman of the session) and CA Keval Shah (Member)

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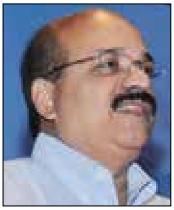
Faculties



Mr. K. Vaitheeswaran, Advocate

CA Pratik Jain

Mr. S. Thirumalai, Advocate (Chairman)

Mr. Nishant Shah Advocate

CA Jayraj Sheth

Republic Day Celebrations

Panel Discussion

Group Photo of IDT Committee along with President, Vice-President and faculties

Group Photo of 7th GST RRC at Hyderabad

CTC Box Cricket Tournament was held on 12th January, 2019 at Dr. Antonio D'Silva School Turf, Dadar

"Winning Team" – Deloitte India LLP (Boys Team)

"Runner up" – Ernst & Young LLP

"2nd Runner up" – BDO India LLP

"Man of the Series" – Mr. Harsh Anand from Deloitte India LLP

"Best Batsman" – Mr. Zaid Kadiwal from Deloitte India LLP

"Best Bowler" - Mr. Rohit Kataria from T. P. Ostwal & Associates LLP

"Winning Team" BDO India LLP (Girls Team)

"Runner up" – PWC India

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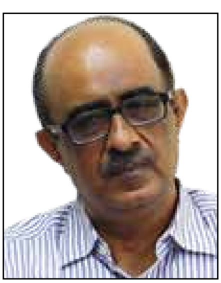
"Woman of the Series" – Ms. Diksha Raina from BDO India LLP

"Best Batswoman" – Ms. Diksha Raina from BDO India LLP

"Best Bowler" Ms. Swati Lahoty from BDO India LLP

IT Connect Committee

SC on How Technology is changing Gig Economy and Microsoft Onedrive held on 1st February 2019 at CTC Conference Room

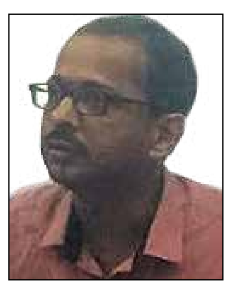


CA Dinesh Tejwani addressing the delegates

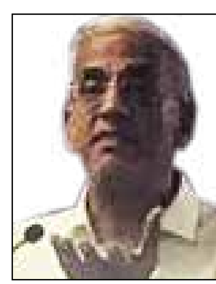
CA Anand Paurana addressing the delegates

Bengaluru Study Group Meeting

Study Group Meeting on "Introduction to MLI & Case Studies on MLI Part II" was held on 17th January, 2019 at FKCCI, Bengaluru



CA K. K. Chythanya addressing the delegates



CA Padamchand Khincha addressing the delegates

RRC & SD Committee | Membership & PR Committee

Surila Yaarana – A musical evening of togetherness for and by the Member of CTC their family and CTC Student Members was held on 11th January, 2019 at Club W-Ballroom, Level: P6, Lodha World Tower, Lower Parel.

Student Committee

Chamber's Debate Competition 2019 in association with H. R. College of Commerce & Economics was held on 18th & 19th January, 2019 at AV Room, 5th Floor, H. R. College.

Day 1

Group photo of judges at preliminary round along with President (CTC), Chairperson (CTC) and Principal (H. R. College)

CA Nishtha Pandya, Chairperson, addressing the participants. Seen from L to R: Mr. Parag Thakkar, Principal, H. R. College, Mr. Percy Pardiwala, Sr. Advocate, Hon'ble Mr. G. S. Pannu, Vice-President, ITAT, Mumbai, Mr. Arvind Sonde, Advocate, CA Hinesh R. Doshi, President

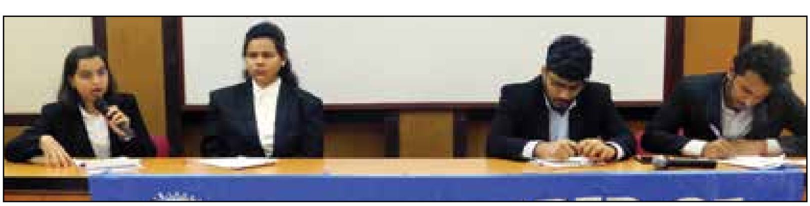
CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: CA Nishtha Pandya, Chairperson, Mr. Parag Thakkar, Principal, H. R. College

Mr. Parag Thakkar, Principal – H. R. College of Commerce & Economics welcoming the judges.

Day 2

Judges at Semi Final round along with President (CTC) and Principal (H. R. College)

Judges of Final Round – Seen from L to R: Hon'ble Mr. G. S. Pannu, Vice-President, ITAT Mumbai, Mr. Arvind Sonde, Advocate, Mr. Percy Pardiwala, Senior Advocate.



Participants in Final Round from Nari Gursahani Law College and M. B. Nayak & Co., CA's.

Hon'ble Mr. G. S. Pannu (Vice-President, ITAT Mumbai) giving his comments to participants for the competition

Winning Team – Nari Gursahani Law College

1st Runner up Team – M. B. Nayak & Co., CA's

2nd Runner up Team – Hinesh. R. Doshi & Co., LLP, CA's

Best Speaker – Ms. Sparsh Khanchandani, Nari Gursahani Law College

Group Photo of Judges & Winners Seen from L to R: S/Shri CA Hinesh Doshi (President), Mr. Arvind Sonde, Advocate, Hon'ble Mr. G. S. Pannu, Vice-President, ITAT Mumbai, Mr. Percy Pardiwala, Senior Advocate, Mr. Parag Thakkar (Principal – H. R. College of Commerce & Economics) and CA Nishtha Pandya (Chairperson).

Indirect Taxes Committee

Workshop on GST Law Jointly with BCAS, MCTC, GSTPAM, AIFTP (WZ) & WIRC OF ICAI was held on 17th & 30th January, 2019 at GSTPM, Mazgaon Library, Mumbai

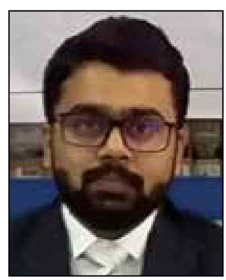
Inaugural Session

CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: CA Aalok Mehta (Jt. Secretary – GSTPAM), CA Deepak Shah (Chairman – AIFTP, WZ), CA Deepak Thakkar (Chairman), CA Pradeep Kapadia (President - GSTPAM), CA Sunil Gabhawalla (President – BCAS) and Mr. Vaibhav Sheth (President – MCTC)

Faculties

CA Rajat Talati

CA Jayesh Gogri



CA Aditya Surte

CA Manish Gadia

President CA Hinesh Doshi had a Meeting with Shri Akhilesh Ranjan, Member CBDT on 6th February, 2019 along with CTC Delhi Chapter committee members. Seen from L to R : S/Shri CA Prakash Kumar Sinha, CA Manoj Kumar, CA Suhit Aggarwal, CA C.S. Mathur, Shri Akhilesh Ranjan, CA Harpreet Singh, CA Hinesh Doshi and CA Sameer Kapoor.

Direct Taxes Committee

Lecture Meeting on TDS Procedures covering Issues on Processing by CPC was held on 29th January, 2019 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate

Dignitaries on dais, Seen from L to R – Mr. Devendra Jain, Advocate, (Chairman) Mr. Ashok Kumar Jha (CIT(A) TDS, Mumbai), Mr. Kumar Sanjay (CIT TDS, Mumbai), Mr. Pratap Singh (CIT (TDS), Mumbai), Ms. Anuradha Bhatia (Principal Chief CIT TDS, Mumbai) CA Hinesh Doshi (President), Mr. V. K. Gupta (CIT (TDS), Mumbai), Mr. Sunil Sharma (CIT-CPC, Ghaziabad) and CA Dinesh Poddar (Vice-Chairman)

CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: Mr. Devendra Jain, Advocate, (Chairman); Mr. Ashok Kumar Jha (CIT(A) TDS, Mumbai), Mr. Kumar Sanjay (CIT TDS, Mumbai), Mr. Pratap Singh (CIT (TDS), Mumbai), Ms. Anuradha Bhatia (Principal Chief CIT TDS, Mumbai), Mr. V. K. Gupta (CIT (TDS), Mumbai), Mr. Sunil Sharma (CIT-CPC, Ghaziabad) and CA Dinesh Poddar (Vice-Chairman)

CA Devendra Jain (Chairman) welcoming the dignitaries and delegates

Faculties

Ms. Anuradha Bhatia, Principal Chief CIT TDS, Mumbai

Mr. Pratap Singh CIT-TDS, Mumbai

Mr. V. K. Gupta CIT-TDS, Mumbai

Mr. Saurabh Arora ITO, CPC TDS, Ghaziabad

Mr. Sunil Sharma - CIT CPC, Ghaziabad

Mr. K. R. Narayana - Jt. Director, CPC Bengaluru

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You save usually for short-term goals like going on vacation or saving money for an emergency.

INVESTOR

LONG-TERM : ATTAIN BIGGER OBJECTIVES

You want to achieve long-term goals. For instance, saving for a child's college education or a holiday home or retiring rich.

EASY ACCESS TO MONEY

You prefer keeping money in cash for an access to meet an emergency need or expense.

YOU HAVE SAVED ENOUGH

You feel you have enough money in the bank to take care of your emergencies.

NEGLIGIBLE RISK

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