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JANUARY - 2014 VOL. II | NO. 4

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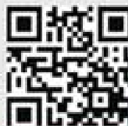

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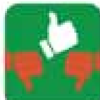
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Workshop on Taxation of Foreign Remittances held on 13th, 14th, 20th & 21st December, 2013 at M. C. Ghia Hall.

CA Yatin Desai, President inaugurating the workshop by lighting the lamp. Seen from L to R : CA Vispi Patel, Faculty, CA Rajesh L. Shah, Convenor and CA Paresh Shah, Chairman.

CA Paresh Shah, Chairman addressing the participants. Seen from L to R: CA Yatin Desai, President, CA Vispi Patel, Faculty, CA Rajesh L. Shah, Convenor.

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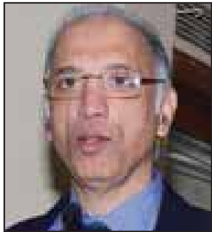

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Shri Sunil D. Shah replying the queries at Brain Trust Session. Seen from L to R : CA Paresh Shah, Chairman, CA M. P. Lohia, Brain Trustees, CA Yatin Desai, President, CA Rajesh L. Shah, Convenor.

Section of delegates.

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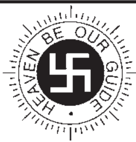

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Editorial

Wish you all a very happy, prosperous and peaceful 2014. Northern India is reeling under a cold wave and half of the United States of America is frozen due to Polar Vortex, but, Mumbai has not witnessed even the regular dip in temperature around this time of the year. For those who are frozen due to fall in mercury may draw some comfort with the words of Shelley – If winter comes, can spring be far behind?

The Special Story of this issue of the Chamber's Journal is on "Current Issues in Capital Gains". We have tried to cover all the live issues. We sincerely hope that this issue will help you in making proper representation in the ongoing assessment proceedings. Eminent professionals have contributed to this issue. A fairly good amount of litigation emanates from the interpretation of the provisions pertaining to capital gains tax. The cash or unaccounted part of the consideration in a real estate transaction is a cause of concern for all. The Executive, as usual, wants to fix this through an amendment to the Income tax Act, 1961 (hereinafter referred to 'the Act') without addressing the larger issues which causes this malaise. The Chamber of Tax Consultants along with other professional organisations repeatedly submitted that provisions like that of section 50C do not address the problem of blackmoney. They only contribute to ever mounting number of appeals before various authorities. The deeming provisions of section 50C of the Act has further contributed to these disputes. As this was not enough sub-clause (b) to section 56(2)(vii) is brought on the statute to tax the amount added in hands of seller under section 50C as

gift in the hands of the purchaser. It is quite interesting to note that similar provisions were brought on statute through Finance (No. 2) Act, 2009. We had made detailed representation pointing out that this shall lead to taxing same amount twice. Good counsel prevailed and these provisions were withdrawn by the Finance Act, 2010. However, same provisions with some changes are re-inserted through Finance Act, 2013. This is not the first time such attempt was made, before section 50C came on statute book the Executive introduced section 52(2), into the Act, which was read down by the Apex Court in the case of *K. P. Varghare vs. Income-tax Officer (1980) 130 ITR 597* (Supreme Court). The Finance (No. 2) Bill, 1998 *vide* clause 25 tried to insert fourth proviso in section 48 w.e.f. 1-4-1999, which had the same implications as present section 50C Professional organisations like ours lodged protest as a result the Finance (No. 2) Act, 1998 didn't have this provision. But the same reappeared as section 50C *vide* Finance Act, 2002. I strongly feel that Chamber should take up this issue again with the CBDT and lodge protest in the strongest possible manner.

I thank all the contributors of this issue for sparing their valuable time for Chamber's Journal.

K. GOPAL
Editor

"Time And health are two precious assets that we don't recognize and appreciate until they have been depleted."

— *Denis Waitley*

From the President

Dear Members,

Wish you all a very happy and prosperous New Year!

At Chamber, the year 2014 begun with an educative note. The Chamber's one of the major programmes, '2nd Residential Refresher Course on Service Tax' was held at Lonavala on 3rd to 5th January. The RRC was very successful in all respects, including selection of subjects and faculty. The RRC was in true sense 'Gyanyagya'. The Chairman Ashit Shah and his team with the guidance of CA A. R. Krishnan managed the entire RRC very well. It was very satisfying to see delegates got their monies worth. Now the entire concentration will be on the forthcoming 37th Residential Refresher Course at Pondicherry scheduled between 13th and 16th February, 2014. The response from the delegates to the RRC is unprecedented. The RRC has been fully subscribed almost two months in advance.

In the coming months, there are major academic programmes scheduled by the Chamber. One may select the programmes listed in the Newsletter, of their professional interest and take benefit of the same. A special mention about the Intensive Course on the Companies Act, 2013 arranged by the Corporate Members Committee. This course is planned so as to make the members aware of the provisions in depth. Along with, academic programmes, the Chamber is also encouraging fellowship and sportsmanship amongst members. The 2nd Cricket match, Chamber's Premier League, 2014 will be played on 18th January 2014. As mentioned in my previous communication, 'The Dastur Essay Competition' for students has been announced. I request members to encourage their students to participate in the same.

On political front, Aam Adami Party (AAP) was elected as a second biggest party in Delhi. Mr. Kejriwal, National Convenor of AAP decided to take oath as a Chief Minister of Delhi. AAP was successful in bringing revolution and provoking masses. It was the Aam (ordinary) prevailing over so called extraordinary and established politicians. It is now to be seen how AAP performs. In my opinion, even if AAP does not perform as expected or promised the damage to the established parties is done. A fear of ordinary is already instilled in the mind of the politicians. If he succeeds in performing, it will be an icing on the cake. Let us hope that he succeeds and bring good governance to the country, which we surely deserve.

The current issue of the Chamber's Journal is on evergreen subject of Capital Gains. I appreciate efforts of Shri C. N. Vaze for providing design and Shri Bhadresh Doshi in co-ordinating the same.

Yatin Desai
President

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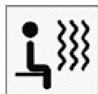

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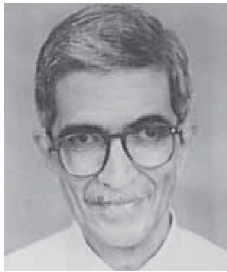

V. H. Patil, *Advocate*

An Introduction to – Ved and Vedanta

Bhagavad Gita

After dealing with some characteristics and the contribution of Bhagavad Gita in March 2013 onward, we started with detailed study of Bhagavad Gita.

Jnyana of Life and Vidnana of Living

Jnyana of (Philosophy) of life is the knowledge of self (Atma) of the God (Paramatma) and of Nature and the interrelation between these three and Vidnana is of the Art of living and the one of achieving Atma's Goal of merging with the Paramatma, to become part of PARAMATMA. The Phrase Yoga means joining, and the ways and methods of achieving the union of 'Atma with PARAMATMA' by various ways (PATHS) by which the goal of achieving Yoga. The paths are Hatha Yoga, Raja Yoga, Dnyana Yoga, Bhakti Yoga and Karma Yoga, and the integrated Yoga of Poorna of Shri Maharshi Arvindo.

In the right view of life and Yoga all is consciously or sub-consciously a Yoga. It is a methodical effort of self perfection and the merging with God.

Now with this background of Jnana Vidnana of life and Art of living (Vidnana), we considered the various PATHS of Yoga and we deat with these ways one by one.

(1) Jnana Yoga the Path of knowledge (2) Raja (Dhyana) Yoga the path of Meditation (3) Bhakti Yoga, the path of love and (4) Karma Yoga, the path of right action.

All persons have the faculty of intellect, of mind, a heart and body, Indriyas (part of the Body). Jnana Yoga, the way of achieving the goal through intellect Raja Yoga (Dhyana) to the reach the same 'goal through mind control. The Bhakti Yoga is through the Heart and Karma Yoga is through Indriyas.

With this background of Yoga and the ways of Yoga, we dealt with them one by one, first we dealt with `Karma Yoga, a Yoga of action, the reason being among various yogas it is most popular and more persons are practicing it, than any other Yoga.

KARMA YOGA

KARMA YOGA SUTRAS

1) One has to do work. One cannot do without doing work. Work is a MUST and, as such, one has to do work.

2) One has to do his work as his duty. Every work which has come to his part, should be performed by him in a spirit of duty and in the spirit of Yajna.

3) The work should be done without any attachment. Work is to be done for work's sake, without any expectation of any kind of result. The work must be done without any desire. Nishkama Karma is doing work unattached and without any desire, and

without any expectation of its fruits. The work done as a duty in the Yajna spirit, is the sum and substance of Karma Yoga.

4) The doing of work in the Yajna spirit that is doing selfless service with a sense of sacrifice is possible, only if one becomes selfless and desireless. Desires and expectations, are the root causes of one's misery and sorrow. If one becomes desireless and expectation less, it is possible to do work in Yajna spirit.

5) If one becomes desireless, and one does not expect any result or craves for fruits of doing a work and if such work is done without attachment then it is possible to adopt the spirit of evenness, towards success or failure, towards happiness or sorrow, towards the gain or loss, towards praise or criticism, towards love or hate. The even mindedness while doing the work or while living itself, is necessary for true Karma Yoga.

6) Doing works in its Yajna spirit is possible if one is really selfless. According to Swami Vivekananda 'Selfishness is PAAP. Selflessness is PUNYA. One who lives for others really lives. One who lives for himself is as good as dead.'

7) True work in the form of service is possible if one cultivates and develops the sense of true love. As all men are equal and all have the same origin and that all human beings are children of God, it is natural to love each other. True love is always selfless and does not expect anything in return. Love for love's sake, should be the motto.

8) The work should be done in the spirit of service. A person whom we love we always want to serve him to make him happy. We are born to serve others. The life is service oriented. As the famous couplet goes "I slept and dreamt that the life is beauty. I woke up and found that life is a duty."

9) As other human beings are representatives of God, and if we see God everywhere and in everybody, serving others would be serving God himself. The true Karma Yogi will find God in human form in everybody and in serving other human beings he feels that he is worshipping God himself. Work for him becomes Puja maya.

10) As the Karmayogi advances in his pursuit of Yoga, he will not claim the authorship of doing any work. Akarta Bhavan will characterise his doing of any work. He realises that it is God only who is doing the work through him. He is only an instrument through whom God works. If the Akarta Bhav is adopted, the work one is doing becomes Dev Maya. 'Nimitta Matvam Bhava' advises Lord Krishna to Arjun. Thus, by stages, the work becomes Premamaya, Sevamaya, Bhaktimaya and Devamaya. By way of an illustration of the works of real Karma Yogi, the following episode from Ramayana be noted. Laxman, when he was fighting Indrajeet, the son of Ravana, fell unconscious. A rare medicine was available in a faraway forest. Hanuman went flying to the forest and brought the whole mountain itself as he could not recognise the medicine required. With the medicine brought by Hanuman, Laxman was cured and regained his consciousness. Lord Rama was very pleased and praised Hanuman a lot. Hearing his praise, Hanuman smiled. When Lord Rama asked Hanuman why he is smiling Hanuman replied "What is this, Bhagavan. You have done all the work through me, and you are unnecessarily praising me." This spirit of Hanuman should be adopted by the Karma Yogi.

11) After surrendering to God and allowing him to do work through him, the Karma Yogi, offers the fruits of his karma to God in the spirit of Samarpana. In fact he offers himself to God.

12) The true Karma Yogi, always remembers God while doing his work. As Lord Krishna advise "All the time, remember me and do your work. One's mind, one intellect, one's heart, and all his work, should become divine. As such, everything must be done in divine spirit, as the work of God. As such, a true Karma Yogi, does the divine work, for God and offers the fruits of such divine work to God. As such, a true Karma Yogi lives divinely, works divinely, does work for divine, becomes God's divine instrument and offers the fruits of his work to God and at the end totally surrenders himself to God. In short, he lives divine life. He does divine work and he merges with God while doing divine work.

13) Lord Krishna, explains that Paramatma himself is a true Karma Yogi. He is always working without any rest, without any attachment, and with equal vision every where. He is not expecting anything in return nor he is getting anything by the work he is doing as a creator, protector and destroys of the Universe.

14) Nature itself is a true Karma Yogi, Whether it is Sun, Moon, river or trees, all are doing their work as real, Karma Yogis. The sun gives light to everybody without any distinction. River gives cool water to everybody without any favour to anybody. Tree gives fruits to everybody, each and every part of tree is useful to the humanity. Agni (fire) and Vau and Akash are all real Karma Yogis.

15) When five elements, by which a human being is made PANCHAMAHA BHUTAH, each and every element is selfless and doing their duties in the Yajna spirit as Karma Yogis, when all five elements are present in the human body, the human being is really duty bound to be Karma Yogi doing work in yajna spirit.

16) In the recent times one would find by way of SAKAR yogis in Swami Vivekananda, Mahatma Gandhi, Maharshi Arbindo and Vinoba Bhave.

Requisites of yoga practice

The process of achieving one's perfection, that one's divinity, is a long drawn and difficult one. However, that being the ultimate goal of human life, one has to achieve it. In this difficult task of achieving, there are certain guidelines to help the aspirant in his path of Yoga. Let us deal with them in brief.

(1) SHRADDHA – Faith and belief

(2) ASPIRATION

(3) DETERMINATION

(4) AVBHYASA – PRACTICE

(5) SAMA DRISTI – EQUANIMITY

(6) TYAGABUDDHI – RENUNCIATION

(7) YAJNA DRISHTI

(8) ANUSMARAN (Remembering)

(9) SAMARPANA – Dedication

(10) SHARANAGATI – Surrender

(11) ACTION AGAINST EVIL

(12) MEDITATION

(13) SATSANG

(14) READING

Yogi's way of living

As we have seen above, a Yogi is in Sansar and at the same time Sansar is not in him. On superficial look he is like any other being. He eats, he works, he sleeps, he talks, all like ordinary human being, but if one observes his living closely one will realise the difference. Here, what he does is not so important. How he does makes all the difference. A Yogi, who is on the right path of Yoga, will have the following elements in his living:

He gets up very early in the morning at about 4.00 a.m. First thing before he leaves his bed, is he prays intensely not for any material things, but for strength, determination, steadfastness

in his pursuit in the goal of life the Union with God. He prays to God that he may see that he will not stray away from his journey towards God. He will pray for Sat Buddhi. He prays for others welfare. He prays that all human beings may attain happiness serve Sukhino Bhavantu. He prays, the gracious Lord for his blessings for all.

After prayers, he repeats his daily morning resolution, that he will not hurt anybody by his thoughts, by his words or by his deeds (Kaya Vachha Manasa). He further resolves that he will at his best, extend help to other human being, by his thoughts, words and deeds. For that purpose, he earnestly prays God for enough strength and determination. He resolves that he will see that all his thoughts are Madhur, his words are Madhur, and deeds are Madhur. Then he reminds himself that he is really Sat Chit Anand. He is pure soul and is part of Lord and his determination to achieve his original Divinity, Sat Chit Anand and he will not stop till he achieves it. He will gradually purify his all thoughts, words and deeds, he will purify his intellect, his mind, his heart, his senses and his body in the goal of attaining total Divinity, in all facets of his existence.

Then he will have some reading of any one of the scriptures. He recites with full devotion, preferably the shlokas of Gita, preferably the shlokas describing the qualities of Sthitha Pragna of Karma Yogi of Gunateeta of Gnani and of Bhakta and tries to imbibe all these qualities in him. He then hears some Bhajans singing the glory of God. He then does his daily “Japa’. After that he starts his daily work. No doubt, like others he also does the same work, but the manner and purpose of his doing work are different. First of all, while doing any work, he remembers God, he does that work for God and dedicates the fruits of the work to God. He is not attached to the work, nor he has any desire for any result. He does everything as duty, he does all the small or big works in the spirit of love, in the spirit of service, in the spirit of worship. All the works he does, he does them as worship of God and whatever fruits he receives out of his worship like work, he offers them with all the devotion and reverence to God. He always remembers that his body, his mind, all his possessions, all belong to God. He knows that all these are given to him for the service of God. He is also quite aware that this service to God, is the service of God in human form, He very well knows that Manav Seva is the best form of worship of Madhav. He sees God everywhere and in everything. With that divine vision he moves in the world. He never misses any opportunity of helping and serving others. He takes it as his privilege to help and serve others and for that he is grateful to them for providing an opportunity to serve them. All his actions, words and deeds are full of love, full of compassion. He is always cheerful and contended. His heart is full of compassion and love. All his work is service of others. All his words are like Nectar. All his thoughts, words and deed in fact all his life is Madhur Madhur Madhur. He has renounced his “I” ness and “My ness”. He is steadfast like a mountain. He is sacrificial like a tree. He is like chandan tree. The chandan tree smears suvas to the face of the axe which cuts it. Like a chandan tree, he also wishes and does well to all those who have harmed him and who have abused him. He maintains his peace and tranquillity at all times at all cost. He accepts everything that has come to his part, whether sorrow or happiness, pleasure or pain, success as defeat, all in the spirit of Prasad, the grace of God. He complains against nobody, against nothing, accepts everything as VARDAAN from God. He is always serene. He is like a air conditioner. Whatever comes to him, he takes from it what is cool, what is pure, like an air conditioner.

He is always vigilant. He time and again introspects, and takes note of his progress. For any deviation from his chosen path, he greatly regrets it and asks forgiveness from God, and punishes himself for that lapse. As far as his own defects are concerned he watches them in microscope and he is a very strict with himself.

But as far as others' defects are concerned, he does not notice them at all. He forgives and forgets any harm done to him, by others.

He always shares others' sorrows and tries his best to console them, sharing their sorrows. He is ready to do anything, sacrifice anything, for the benefit of others I am here reminded of an episode from Mahabharat, relating to that Great Karma Yogi, Raja Janak, the father of Seeta Raja Janak, was such a great Karma Yogi that, Geeta, while illustrating Yogis refers to Raja Janak, as model Yogi. No doubt as he was great Yogi, he was bound to go to heaven. However he had committed a minor sin as a punishment for that he was to pass through the hell before going to heaven. When he came near the hell along with Devadoots accompanying him, there he heard lot of cries of pains and sufferings. He asked doots accompanying him, as to what for these cries and suffering. The doots explained to him, that these cries and sufferings are of those who have come to the hell, to suffer the punishment, for the sins committed by them on the earth. When Raja Janak entered the hell, all cries and, suffering stopped at once and there was cool peace everywhere. When Raja Janak asked the doots what was the reason for this sudden change. The devdoots replied, that the presence of the Great Yogi Raja Janak, has brought in the peace, and relief from pains and sorrows. Then devdoots requested Raja Janak, to proceed with them to the Heaven Raja Janak refused and remarked that if his presence in the hell would give relief and peace to so many people, let him continue to live in hell and he does not want to come to heaven. Such is the sense of sacrifices of a real Karma Yogi. To the same effect is an episode from Lord Buddha's life. When Lord Buddha completed his journey in this world, he was entitled to and was offered, Nirvana, But that great soul, refused to accept Nirvana stating that he will take Nirvana after all human beings got Nirvanas. Swami Vivekananda advises, Go to hell yourself to buy salvation for others there is no mukti on earth to call my own. There is an episode from the life of Vivekananda, where a similar advise was given to him by his Guru Ramakrishna Paramahans. Once when the Guru, asked Vivekananda, as to what he wants, Narendra (Vivekananda) replied he wants mukti. The Guru fired him what is this why you are so selfish to ask mukti for yourself. No you have come here to do lot of good work for the benefit of others. You have to help others to get mukti and should not desire mukti for himself. Yes according to these great souls even desiring 'Mukti' for oneself is selfishness, then now can they desire for any worldly things?

The Yogi acts as a Moon, Moon takes away the heat from Sun rays and gives everybody cool rays, similarly a true Karma Yogi, tries to take away sorrow from others and tries to give them relief from suffering, by showing great 'Sahanubhooti' sharing the sorrows of others.

The yogi's way of life, of worshipping God in human forms, is well described by Swami Vivekananda in his poem.

"From highest Brahmin to the Yonder Wam to the Minutes atom.

Everywhere is the same God the all love

Friend offer mind soul body at their feet

These are his manifest forms before thee

Rejecting them where seekest thou for God

Who loves all beings without distinction

He indeed is worshipping best his God"

Yogi believes, and acts, that he has to live for others and not for himself.

Yogi believes in giving and never expects or accepts anything in return not even name and fame. He believes that charity done by his right hand should not be known even to his left hand.

Yogi's works deeds by gradual process, become Premamya, Seva Maya, Yajna Maya, Pooja Maya and ultimately Deva maya. At the final stage of his progress he only becomes a divine instrument in the hands, of God, like a flute in the hands Lord Krishna, through which God gets his Godly works done. He gets his Mukti Salvation when he is still alive.

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Capital Gains – Computation – Overview

1. Introduction

This Special Story on 'Capital Gains' has been so well designed to cover all issues of current importance and also the recent amendments. My compliments to all those, who have contributed in designing this Special Story. The issues have been classified and divided into different articles wherein the authors have meticulously analysed the relevant provisions, explained the issues and have also given their expert opinion on such issues. This Special Story will be of great help and assistance in the professional practice of our members and the readers and also the assessees in understanding the provisions of law relevant for their assessment. In this first article in this Special Story. I am required to cover brief overview on the provisions on capital gains touching upon some issues of general importance, important issues concerning the computation and also some recent amendments.

1.1 Levy of tax on Capital Receipts

The charge of tax under the Income-tax Act, 1961 is only in respect of the receipts which constitute income in the natural sense and those which are deemed to be income in the inclusive part of the definition. Thus a receipt which does not constitute income in the natural sense nor specifically included in the definition as income would not be chargeable to tax under the Act. Those receipts which constitute income are generally called revenue receipts. In contrast, those receipts which do not constitute income are called capital receipts. Thus the legal position even as on today is that a revenue receipt is chargeable to tax and capital receipt is not chargeable to tax. Generally a return or realisation of capital is not income but is a capital receipt. Similarly a compensation received for immobilisation, sterilisation, destruction or loss, total or partial, of a capital asset is a capital receipt. A reimbursement is a receipt on capital account. A gift or a loan is not an income. A realisation of a capital is a receipt on capital account and not an income even though the receipt may exceed the cost of the outlay. A capital receipt is not an income in its normal sense. In *CIT vs. Maheshwari Devi Jute Mills Ltd. 57 ITR 36 (SC)* the Hon'ble Supreme Court held that a consideration received on a transfer of a capital asset is not chargeable to tax. The Court held:

> "There is no doubt that when a businessman disposes of his capital for whatever reason, unless it is a part of his circulating capital, the receipt is capital and not income which is taxable."

In *BG Shah vs. C.I.T. 162 ITR 23 (Bom)* Hon'ble Bombay High Court held that the tenancy right is a capital asset and compensation received on surrender of tenancy right is a capital receipt and not a revenue receipt. The Hon'ble Court held:

> "The assessee had obtained the tenancy intending to use the premises for the purpose of carrying on his business. There was nothing to suggest that he intended to trade in tenancy. The tenancy was, therefore, a capital asset and the sum of ` 37,500/- received by the assessee as compensation when the agreement was terminated for non-performance of the same was a capital receipt."

1.2 Tax on Capital Gain

Up to A.Y. 1946-47 capital gain was not chargeable to tax. Capital gains were charged to tax for the first time by the Income-tax and Excess Profits Tax (Amendment) Act, 1947, which inserted section 12B in the Indian Income-tax Act, 1922. Tax was chargeable in respect of transfer of capital assets after 31st March, 1946. The levy was virtually abolished by the Finance Act, 1949, which confined the operation of the section to 'capital gains' arising before 1st April, 1948. The Finance (No. 3) Act, 1956 re-introduced section 12B and covered transfers effected after 31-3-1956. Under the Income-tax Act, 1961 (the Act), capital gain is charged to tax u/s 45 of the Act.

A capital receipt is not an income in its normal sense. A capital receipt can be charged to tax, only if and only to the extent it is specifically included in the inclusive part of the definition of income u/s. 2(24) of the Act. Such inclusive part is to be found only in clause (vi) of section 2(24) of the Act which reads as under:

"vi) Any capital gains chargeable u/s 45."

Thus a capital receipt which is not chargeable to tax u/s 45 would not constitute income and hence cannot be taxed under the Act. Accordingly, if a capital receipt cannot be charge to tax u/s. 45, as capital gain, for whatever reason then it would not be chargeable to tax under the provisions of the Act. That is to say that a capital receipt cannot be charged to tax under any other head, except the head "capital gain". This principle has been consistently followed by all Courts.

2. Section 45

Sub-section (1) of section 45 of the Act is the basic provision for charging the capital gains. It provides that a profit or gain arising out of transfer of a capital asset is chargeable to income tax. Thus, for charging capital receipt to tax the following three conditions must be satisfied.

a) There should be a capital asset;

b) There should be transfer of capital asset; and

c) The capital gain should be computed in accordance with the provisions of the Chapter.

If any of the three conditions is not satisfied then that receipt is not chargeable to tax.

2.1 Capital Asset – Section 2(14)

Section 2(14) of the Act defines 'capital asset' to mean property of any kind held by an assessee. The definition also excludes from the term 'capital asset' certain properties viz., personal effects, such as wearing apparel, furniture etc. held for personal use, agricultural land and certain bonds. Thus, where a personal effect, like a personal car, furniture etc., or an agricultural land or a specified bond which has been excluded

from the definition of a 'capital asset' is transferred or sold for a consideration, then the profit or gain on transfer of such property will not attract capital gains tax since the property transferred does not constitute a 'capital asset'. Therefore, when these assets are sold, the sale consideration is not taxed as income, as the same is not chargeable to tax u/s. 45.

2.1.1 Agricultural land

Section 2(14) of the Act excludes a rural agricultural land from the definition of a 'capital asset' and as a result, profit and gain from sale of rural agricultural land is not liable to capital gains tax. An urban agricultural land is not excluded from the definition of 'capital asset' and accordingly, the profit and gain on sale of an urban agricultural land will be liable to capital gains tax. An urban agricultural land is a land situated in the urban area i.e., within the jurisdiction of municipality or the cantonment board having population more than ten thousand. Sale of such land would attract capital gains tax. Urban land also includes a land outside the urban area and situated within the specified distance from the local limits of such urban area. Up to the A. Y. 2013-14, such specified distance was eight kilometers. The amendment by the Finance Act, 2013 has divided this distance into three parts. In the case of the urban area with population between 10,000 and 1,00,000 the specified distance is two kilometers. Where the population is between 1,00,000 and 10,00,000 the specified distance is six kilometers and in case of urban area having population more than 10,00,000 the specified distance is eight kilometers. This amendment is applicable from A. Y. 2014-15 onwards.

While applying these provisions, question arose as to the method of measuring the distance. One option was the distance by road and the other was the aerial distance. Courts had taken the view that the distance has to be measured by road. The Finance Act, 2013 has amended the provision and has provided that the distance has to be measured aerially. The amendment takes effect from 1-4-2014 i.e. for A.Y. 2014-15 onwards. Thus, up to the A.Y. 2013-14 the distance will have to be measured by road and for the A.Y. 2014-15 onwards the distance will have to be measured aerially.

2.2 Transfer

Section 2(47) of the Act, defines transfer of a capital asset for the purpose of capital gains tax. It is an inclusive definition which has expanded the concept of transfer as provided in clauses (i) to (vi) therein. Where a transaction does not amount to transfer of a capital asset it would not attract capital gains tax. Section 47 of the Act, specifies the transactions which are not regarded as transfer for the purpose of capital gains. Thus a transaction specified in section 47 will not be treated as transfer for the purposes of capital gain even if it is a transfer as defined in section 2(47) of the Act. Such transactions will not attract capital gains tax.

The date/year of transfer is material for levy of capital gains tax. In the case of compulsory acquisition as provided in clause (iii) of section 2(47) the compensation received on such compulsory acquisition is taxable in the year of receipt of compensation as provided in section 45(5) of the Act. In the case of transfer by way of conversion of capital asset into stock–in-trade as provided in clause (iv) of section 2(47) the capital gain is chargeable to tax in the year of sale/transfer of the stock-in-trade as provided in section 45(2) of the Act. In all other cases, the tax on capital gains is leviable in the year of transfer. Therefore, it is important and material to know the year of transfer. The date of transfer will have to be decided on the basis of the agreement/contract between the parties which may itself provide for the date/year of transfer. In that event the year of transfer will be the year so agreed upon in the agreement/contract. In

so deciding the year of transfer the conduct of the parties is also material. If the date of transfer is not contractually decided then it will have to be decided on the basis of the definition of transfer as provided in section 2(47) of the Act. As for example, in the case of a transfer of a land under a development agreement the provisions of section 2(47)(v) would be attracted and the year of transfer will have to be decided on the basis of the development agreement and the conduct of the parties. If the possession of land is given to the developer on receipt of part of the consideration then there will be a transfer and the capital gains tax would be leviable in that year. However, if the possession is not given to the developer or no part of the consideration was received from the developer then there would be no transfer and the levy of capital gains tax would not be attracted.

Similarly, in the case of conversion of tenancy rights into ownership rights of the same property, there is an exchange of one property (tenancy right) with another property (ownership right) and the possession of the property continues with the same person. In such a case, transfer takes place on the date of conversion and the capital gains tax would be leviable in the year of conversion. However, in the case of exchange of tenancy right of one property with the ownership right of another property the transfer will take place in the year of surrender of tenancy right and will accordingly be liable to capital gains tax in that year.

3. Computation of Capital Gains; S. 48

3.1 Section 48 of the Act provides the mode of computing capital gains. Capital gains is computed by deducting from the full value of consideration the following three items:

i) Expenditure incurred wholly and exclusively in connection with the transfer i. e. expenditure incidental to transfer;

ii) The cost of acquisition of the asset; and

iii) The cost of improvement.

When the expenditure incidental to transfer is reduced from the full value of consideration the resultant amount is termed as the net consideration. Where the computation machinery fails it has been held that the charging provision will fail. In *CIT vs. B.C. Srinivasa Setty 128 ITR 294 (SC)* the Hon'ble Supreme Court held that on transfer of self-acquired goodwill the consideration receivable is not chargeable to tax since the cost of acquisition is nil. The Court held that for the purpose of capital gain, the capital asset contemplated is an asset in the acquisition of which it is possible to envisage a cost and the intent goes to the nature and character of the asset, that it is an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. This judgment has been applied in the case of other assets such as licences, permits, trade marks etc., having no cost or in which cost is not determinable or ascertainable. Similarly, where the cost of improvement or the full value of consideration is not determinable the computation provisions would fail and the resultant capital gain would not be chargeable to tax. So as to overcome such decisions the law has been amended from time to time defining the cost of acquisition, cost of improvement and full value of consideration as the case may be. However, the principle laid down by the Hon'ble Supreme Court in the case of *CIT vs. B.C. Srinivasa Setty 128 ITR 294 (SC)* will still be applicable to assets and transactions which are not covered by the amendments.

3.2 Cost of acquisition on conversion of tenancy into ownership

In *Ajit M. Pendurkar vs. ITO (Mum.)(Trib.);* ITA No. 3225/Mum/ 2009 dated 19-12-2012, the assessee was a tenant of the house property since 1984. In terms of a Government scheme he became owner of the property on 4-3-2003 on payment of ` 45,062/-. He sold the property on 31-10-2004. The Assessing Officer computed the short term capital gain at ` 24,54,500/- by taking the cost of acquisition at ` 45,062/- ignoring the value of the tenancy right. The Tribunal held that the cost of acquisition of the ownership house property would be the market value of the tenancy right as on 4-3-2003 plus the sum of ` 45,062/- paid by the assessee for conversion into ownership.

3.3 Indexed Cost

The second proviso to section 48 provides that in the case of long term capital gain 'indexed cost of acquisition' and 'indexed cost of improvement' shall be deducted from the full value of consideration instead of the 'cost of acquisition' and the 'cost of improvement'. Explanation (iii) to section 48 provides that 'indexed cost of acquisition' is the amount that bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the first day of April 1981, whichever is later. Explanation (iv) to section 48 provides that 'indexed cost of improvement' is the amount that bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place. This is basically with a view to neutralise the inflation effect on the cost.

3.3.1 In case of asset acquired by succession, inheritance, devolution, gift, will etc.

As noted above, for the purpose of indexation, the Cost Inflation Index of the first year in which the asset was held by the assessee has to be taken into account. Section 49(1) of the Act provides that where the asset is acquired by the assessee by succession, inheritance, devolution, gift, will etc. (clauses (i) to (iv) of s. 49(1)) the cost to the previous owner shall be deemed to be the cost to the assessee. Explanation to section 49(1) defines 'previous owner' to be the last previous owner who acquired the capital asset by a mode of acquisition other than that referred to in clauses (i), (ii), (iii) and (iv) of section 49(1). Similarly, for the purpose of determining the short-term or long term nature of the capital asset, the period of holding of the asset by the previous owner has to be taken into account. Consistent with this scheme, it has to be inferred that for the purpose of indexation also the period of holding of the asset by the previous owner has to be taken into account. But this was not acceptable to the Department and the Assessing Officers computed the indexed cost with reference to the year in which the asset was first held by the assessee himself ignoring the period of holding by the previous owner.

In *CIT vs. Manjula J. Shah; 355 ITR 474 (Bom.);* the Hon'ble Bombay High Court has rejected the stand of the Department and held that the indexed cost has to be computed with reference to the year in which the previous owner acquired the asset and not the year in which assessee acquired the asset. In this case, the assessee's daughter, the previous owner, originally acquired the capital asset (flat) on 29-1-1993 and the assessee acquired the flat under a gift deed dated 2-1-2003. The assessee sold the flat in 13-6-2003. The asessee computed the indexed cost on the basis of the Cost Inflation Index for the

F. Y. 1992-93 being the first year in which the asset was held by the previous owner. The Assessing Officer computed the indexed cost on the basis of the Cost Inflation Index for the F. Y. 2002-03. The CIT(A) and the Tribunal accepted the assessee's claim and rejected the stand of the Department. The High Court upheld the decision of the Tribunal.

In the case of *CIT vs. Ms. Janhavi S. Desai; 209 Taxman 289 (Bom.); 252 CTR 518 (Bom)* the assessee's father had acquired a property prior to 1-4-1981. The assessee's father expired on 21-8-1988 when the assessee inherited 50% of the property and the assessee's mother inherited balance 50%. The assessee's mother expired on 21-2-2000 when the assessee received the balance 50% by inheritance. The assessee sold the property in the A. Y. 2005-06 for a consideration of ` 9.50 crores and computed the capital gain of ` 38,44,247/- by adopting the indexed cost of acquisition w.r.t. 1-4-1981. The Assessing Officer computed the indexed cost w.r.t. 21-8-1988 in respect of 50% property inherited from father and w.r.t. 21-2-2000 in respect of 50% property inherited from mother. The CIT(A) allowed the assessee's claim. The Tribunal allowed the assessee's claim in respect of the 50% inherited from the father and held in respect of the balance 50% inherited from mother that the indexation should be w.r.t. 21-8-1998 when the asset was first held by the mother. The Bombay High Court referred to the definition of the previous owner as defined in Explanation to section 49(1) and allowed the assessee's claim.

3.4 Full value of consideration

As held by the Hon'ble Supreme Court in *CIT vs. George Henderson and Co. 66 ITR 622 (SC),* full value of consideration is the price bargained for by the parties to the sale and it cannot be construed as the market value of the capital asset. Thus the full value of consideration is the actual consideration received or receivable under the contract for sale.

3.4.1 Section 50D

As observed above, where the full value of consideration for the transfer of the capital asset cannot be determined or is not ascertainable the machinery provisions would fail and the resultant capital gain will escape from tax. So as to overcome such a situation, section 50D has been inserted by the Finance Act, 2012 w.e.f. A. Y. 2012-13 for adopting the fair market value as full value of consideration, whenever the actual consideration cannot be determined or is not ascertainable. Thus the provisions of section 50D are not applicable in the case where the actual consideration is determinable or ascertainable.

4. A sincere attempt has been made to cover some important issues as desired from me. I hope this will satisfy the requirement of the readers.

"When health is absent, wisdom cannot reveal itself, art cannot manifest, strength cannot fight, wealth becomes useless, and intelligence cannot be applied."

— *Herophilus*

CA C. N. Vaze

Taxability of Capital Gains in the hands of firm and partners in case of Restructuring of Partnership Firm

Introduction

Partnership, by and large, is still the most popular form of people coming and staying together – in life as well as in business. All the unions of human beings pass through the stages of forming, storming, norming and performing. It is, therefore, worthwhile studying the legal and tax implications involved in reconstitution/change in constitution of partnership. There may be occassionally changes in the constitution of the firm. In most cases, this is carried out either through a retirement or an admission of one or more partners, with some of the existing partners continuing. In such a case, for purposes of taxation, the same partnership firm is regarded as having continued with a change in constitution. Even if the change has occurred in the middle of a year, only one assessment is made for the year on the firm on its income for the entire year (Section 187). The proviso to Section 187 clause (a) of the said section shall not apply where the partnership is dissolved due to death of any one of the partners. The Income-tax Act, 1961 [The Act] contains various provisions relating to assessment of firm, disallowance of remuneration and interest to partners in excess of certain limits, exemption to a partner in respect of his share in the total income of the firm, carry forward of losses in case of change in constitution and on succession, etc. However the scope of this article is restricted to capital gains implications in case of retirement and admission of partner(s). The article is divided into two parts –

Capital Gains implications in case of

Part A – Retirement of Partner(s) and

Part B – Admission of New Partner(s).

Part A – Retirement of Partner(s)

TAXABILITY IN THE HANDS OF FIRM AND PARTNER(S) IN CASE OF RETIREMENT

Under Chapter IV-E of the Income Tax Act, 1961, provisions with respect to capital gains have been made. The charging Section, Section 45 contains the following provisions on chargeability of capital gains on change in constitution of partnership.

1. Section 45(4) – Dissolution (including retirement)

Section 45(4) states that when the capital assets of the firm are distributed on dissolution or otherwise, the capital gain is chargeable to tax in the hands of the firm.

The fair market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer.

1.1 Application of section 45(4)

It is first to be noted that section 45(4) applies only when there is a distribution of asset in specie and not when cash is distributed. It covers only capital asset and not stock-in-rade. The point of time of application of section 45(4) was discussed in *CIT vs. Vijayalakshmi Metal Industries (2002) 256 ITR 540 (Mad.)*. The court held that dissolution by operation of law may take place on the demise of one or two partners. However, that would not imply that there is notional transfer of capital asset and that the capital asset of the erstwhile firm stood transferred to other partner or other partners entitled to claim the share of the dissolved firm. Until such time the capital asset is transferred by way of distribution no occasion arises for bringing to tax any capital gain on a transfer which has never taken place. The date of dissolution is not to be taken as the date on which 'transfer' of capital asset(s) had taken place. Thus, the point of application shall be date on which the capital assets are actually transferred/distributed.

The following four conditions are to be fulfilled so as to attract liability of capital gains under section 45(4):

1. There should be dissolution of a firm,
2. There should be distribution of capital asset
3. There should be transfer of capital asset and
4. Profits and gains should arise by transfer

1.2 Also the words "capital assets of the firm are distributed on dissolution or otherwise" used in sec.45(4) have been subject of various rulings:

CIT vs. A.N.Naik Associates & Another (2004) 265 ITR 346 / 136 Taxman 107 (Bom.).

The word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. Thus distribution of asset by the firm to a partner on his retirement shall come within the expression 'otherwise' (in section 45(4)) and amounts to transfer of capital assets within the meaning of section 45(4) and therefore is liable to capital gains in the hands of the firm.

Further, in *CIT vs. R. Lingamallu Raghukumar, 247 ITR 801 (SC)* when a partner of firm retires and the amount of his share in the partnership assets after deduction of liabilities and prior charges is determined on taking accounts, there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners. The amount received by the retiring partner is not liable to tax as "Capital Gains" u/s. 45 of The Act.

However, it has been held in the following decisions of Hon'ble Bombay High Court that, instead of quantifying his share by taking accounts on the footing of notional sale, parties agree to pay a lump sum in consideration of the retiring partner assigning or relinquishing his share or right in the partnership and its assets in favour of the continuing partners, the transaction would amount to a transfer within the meaning of s. 2(47) of the Act and will attract the provisions of capital gains

- *Tribhuvandas G. Patel's case [1999] 236 ITR 515;*
- *CIT vs. H. R. Aslot [1978] 115 ITR 255 (Bom);*
- *N. A. Modi's case [1986] 162 ITR 420;*

a) If retiring partner's account is settled by paying in cash

There is a doubt as to whether section 45(4) is attracted in case the retired partner is merely paid the cash equivalent of his share in the value of the partnership firm on his retirement. As already noted above, section 45(4) is attracted not only in case of dissolution but also in the event of distribution of assets among the partners even in any other manner. The retirement also necessarily involves distribution of assets even where the retiring partner(s) receives only cash equivalent and the continuing partners receive the various capital assets of the firm.

Another point of view is that even if the words "or otherwise" in section 45(4) are interpreted as bringing retirement into the net of capital gains, the other condition to be fulfilled for the applicability of section 45(4) is that there should be transfer of asset by way of distribution. The word "distribution" makes it obligatory that something should be parted with by the firm. Then in view of the fact that entire capital assets remain with the firm, there is no transfer of any capital asset by the firm. The applicability of section 45(4) appears to be difficult in such cases as the mode of computation under section 45(4) is by determining the fair market value of the asset transferred to the partners on distribution and there is no proper manner in which the appropriate share of a retired partner can alone be subjected to tax. Having regard to the above it can be said that section 45(4) shall not apply.

It has recently been decided that, when retiring partner takes only money towards the value of his share and when there is no distribution of capital assets/assets among the partners there is no transfer of capital asset and consequently no tax is payable by firm under section 45(4) of the Income-tax Act, 1961. *[CIT vs. Dynamic Enterprises (HC – Karnataka) dated 16-9-2013, Full Bench Decision]*

The deed of retirement needs to be carefully drafted so as to ensure that the retirement does not involve a transfer. Otherwise a retiring partner may become liable to pay capital gains tax as was held by Bombay High Court in the following two cases:

- *Tribhuvandas G. Patel's case [1999] 236 ITR 515;*
- *N.A. Modi's case [1986] 162 ITR 420.*

Moreover, where a partner retiring from the firm receives a sum more than the amount standing to his credit, such excess is taxable as capital gains – *Bishan Lal Kanodia vs. CIT (2002) 257 ITR 449 (HC - Del.)*

b) If retiring partner's account is settled in the form of assets

It is an important proposition of law that a firm is not a legal entity and it does not have a separate existence apart from its partners. Therefore, a firm by itself cannot own any asset and it has no separate rights. It is the partners who jointly hold the assets. Therefore, the transfer of assets between the firm and its partners are to be viewed in this context.

c) Retiring Partner is given a part of particular asset (belonging to a block)

Under the present system of block of assets, there is no question of levy of capital gains in case of depreciable assets so long as the block continues. Capital gains become chargeable only when the block account is converted into nil or the account shows a credit balance. The credit balance, in some circumstances, is to be treated as a short term capital gain. In other words there is no possibility of any long term capital gain accruing in case of depreciable asset. If a part of the assets, belonging to a

block, is given to a retiring partner and the block of assets account is not allowed to be converted into credit, there will be no levy of capital gain. If there is a possibility of such occurrence, an addition can be made to the block and thereafter the distribution may be planned.

Further in the case of distribution of depreciated assets of the firm to the partners it has been held that the provisions of Section 45(4) and not Section 50(1) would be applicable as what is contemplated under Section 50 is the sale of depreciated assets and not its distribution of assets. Refer – *CIT vs. Kumbazha Tourist Home (2010) 328 ITR 600 (Ker.)*

When an asset is distributed to a partner, even though he handed over the asset to the firm with the condition that he will be given the same back on his retirement, the transaction will be regarded as transfer. But since it has taken place under a contractual obligation, it is possible that the Assessing Officer may not press for substitution of the consideration by the fair market value on the date of such distribution.

d) Distribution to partner on dissolution vs. Gift of land to Partner

So far as registration is concerned, gift of land to partner is required to be registered under Indian Registration Act, 1908, but the distribution of land to partner on dissolution of the firm, doesn't require registration, as decided in *N. Khadervali Saheb vs. N. Gudu Sahib [2003] 261 ITR 1 (SC)*. So far as taxability is concerned, gift of capital asset being a land, is exempt u/s 47(iii), but distribution of land on dissolution is taxable u/s. 45(4). Thus, decision as to gift or distribution on dissolution is to be taken after taking this into consideration.

The above decision can also be applied in case of distribution of assets to partner on retirement as well as distribution to partner on retirement is also covered under section 45(4).

Readers may be aware that a firm is also eligible for claiming exemption under section 54 EC in respect of capital gains. If the capital gains arise on dissolution under section 45 (4), an issue arises as to in whose name the investment be made?

A practical solution may be that the bonds be subscribed by the partners jointly or in the individual names of the partners in proportion to their respective shares.

e) Enhancing the value of assets and settlement of retiring partners

In case the retiring partners are receiving balance in their capital accounts including the revaluation reserve on valuing assets of the firm at market value, the firm continues to be owner of the property and there is no change in ownership of the property of the firm. Though all partners have a share in assets of the firm it is not a specific share and neither on retirement nor on admission of partners there is transfer of any right in property of the firm. Further, on retirement, the retiring partners are getting their balance of capital account from the firm. Receipt of such funds is realisation of asset and there is no transfer by the retiring partners attracting any capital gain tax liability. The case of retiring partner is fully supported by decision of the Hon'ble Supreme Court in *Tribhuvandas G. Patel, 236 ITR 515 and Mohanbhai Pamabhai, 165 ITR 166.*

However, it is be noted that the Karnataka High Court has in the recent decision of *CIT vs. Gurunath Takies [328 ITR 59(2010)]* held that in case where the partners who contributed to the property of the firm retire from the firm leaving behind the property in the firm, it amounts to a transfer of

immovable property by the retiring partners in favour of the continuing partners and amounts to transfer as understood u/s 45(4) of the Income-tax Act. The decision though unfortunate is bound to be used by the Assessing Authorities in all cases where property was transferred through this methodology. The decision of the Mumbai Tribunal in the case of *Shri Sudhakar M. Shetty vs. ACIT (supra) [2011] 130 ITD 197 (Mum.)* also appears to have adopted the same view.

Settlement of retiring partner(s) by revaluation of assets should not have capital gain implication on the firm since the assets of the firm continue to remain with the firm.

It is worthwhile to note that if the assets received by the partner on retirement are sold by him, the cost of acquisition to the partner shall be deemed to be the value which was adopted for the settlement of his account and not the fair market value which was taxed in the hands of the firm under section 45(4).

For applicability of section 50C vis-à-vis section 45(4) and 45(3) refer para no. 3

Part B – Admission of Partner(s)

TAXABILITY IN THE HANDS OF FIRM AND PARTNER(S) IN CASE OF ADMISSION

2. Section 45(3)

The profits and gains arising from the transfer of a capital asset by a person to a firm (not being company or co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as his income of the previous year in which such transfer takes place and for the purposes of Section 48, the amount recorded in the books of account of the firm as the value of capital asset shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

Section 45(3) applies when a capital asset is introduced into a firm as capital contribution. However it has been held in *DLF Universal vs. DCIT (ITAT Delhi Special Bench)*, January 10th, 2010 that provisions of section 45(3) shall also apply when stock-in-trade is introduced into a firm because the transaction is on the capital account and stock-in-trade does not retain its character as stock-in-trade at the point of time of introduction. Consequently, the gains on such transfer is taxable u/s. 45(3).

Thus, at whatever amount the asset is brought in the books of account, the capital gain in the hands of the partner will be computed on the basis of the value recorded in the books of account as consideration. It may be planned that a reasonable amount may, while transferring the asset to the firm, be credited to the capital account of the partner in the books of partnership and the capital gain may be assessed in the hands of the partner who is also entitled to avail the benefit of deduction under section 48 in respect of indexed cost of acquisition under section 48(1) if the gain is long term.

Thus, though the provisions of section 45(3) now bring, within the net of capital gains, the assets contributed by a partner, there still can be some planning for saving the tax burden and the provisions of section 45(3) may be utilised for the purpose of such planning.

As such, if not otherwise beneficial, the capital should be contributed in cash only and not in the form of capital asset.

Recently, the Karnataka High Court in the case of P.N Panjawani, held that any reduction in share of a partner in the partnership firm on admission of new partners does not amount to transfer of

share in the landed property of the firm and accordingly, the same cannot be taxed in the hands of the existing partners.

3. Section 50C vis-a-vis Sections 45(3) & 45(4)

The question as to whether section 50C shall override section 45(3)/45(4) has been a debatable issue. However the same was put to rest by the decision of ITAT Lucknow Bench 'A' in case of *Carlton Hotel (P.) Ltd. vs. Assistant Commissioner of Income-tax [2010] 35 SOT 26 (LUCK.)(URO)* where it was held that:

- Section 50C cannot be put into operation where:
  - agreement or sale deed is not registered and stamp duty is not paid; or
  - capital gains is simply charged by deeming certain transactions as transfer as per other provisions of Act or
  - some transactions of transfer are not registered or are not legally required to be registered under Registration Act.
- However section 50C being a special provision, would override section 45(3) if sale deed is sought to be registered by paying stamp duty.
- Where such registration does not take place by paying stamp duty, that case would only be covered under section 45(3) and, therefore, value recorded by firm in its books would only be full value of consideration for purpose of computing capital gains

It is to be noted that immovable property distributed to partners on dissolution of the firm do not require registration as it is only a settlement of pre existing right.

Ref: *S.V.Chandra Pandian vs. S.V.Sivalinga Nadar and Others (1995) 212 ITR 592 (SC).* Also there is a view that the introduction of an immovable property by a partner to a firm does not require registration.

However, by virtue of an amendment in section 50C, w.e.f. 1-4-2009, the word 'or assessable' have been added so that mere non-registration may not save the assessee from the clutches of section 50C. Thus, whether section 50C will override section 45(3) and section 45(4) is a debatable issue.

4. Miscellaneous Points

4.1 The focus of the article was the implications of capital gains. However, the mischief of section 56 should be borne in mind while dealing with transfers from firm to individual partners.

4.2 Section 78 of The Act deals with c/f of losses. It says that the share of loss attributable to the retiring partner lapses & cannot be c/f. The same may apply to the loss under head capital gains.

5. Conclusion

The subject, as usual is endless and many issues still remain unresolved. I thank the Chamber for this opportunity to express my views on this very relevant topic. This sharing of views is helpful in tackling the problems and sharing the worries created by different interpretations. In that sense, this in itself is a partnership of thoughts.

Rahul K. Hakani, *Advocate*

Issues arising u/s. 50C

1. Introduction

As per Section 48 of IT Act, 1961, full value of consideration on transfer of a capital asset is the consideration received or accruing on such transfer. Hence, the actual sale consideration is relevant for computation of gains and not the fair market value as is held by the Supreme Court in *CIT vs. George Henderson & Co. Ltd. (1967) 66 ITR 622* & reiterated in *CIT vs. Gillanders Arbuthnot & Co. (1973) 87 ITR, 407 (SC),* except where full value of consideration has been specifically substituted by fair market value or by any other mode. Section 50C is a special provision which substitutes actual consideration received or accrued on transfer of capital asset being land or building or both with Stamp Duty valuation as the full value of consideration under section 48.

2. Scheme of provision of Section 50C

The Finance Act, 2002, is inserted by Section 50C in the Income-tax Act, 1961 with effect from 1-4-2003.

Briefly speaking, sub-section (1) of section 50C deems as the full value of consideration received or accruing on the transfer of a capital asset, being land or building or both the value adopted or assessed or assessable for the purpose of stamp duty by the concerned State Government authority where such value is higher that the consideration shown in the transfer deed. Under sub-section (2) the assessee may claim that the value adopted for stamp duty purposes exceeds the fair market value of the property as on the date of transfer and, in such a case, the Assessing Officer if he does not agree with the assessee, should refer the valuation of the property concerned to a Valuation Officer. Sub-section (3), thereof provides for the adoption of the stamp duty or the value determined by the Valuation Officer whichever is less.

3. Constitutional validity

3.1 The Constitutional validity of S.50C has been upheld by Madras High Court in *K.R. Palanisamy & Ors. vs. UOI & Ors. (2008) 306 ITR 61(Mad.)* and Bombay High Court in *Bhatia Nagor Premises Co-op. Soc. Ltd. vs. UOI & Ors. (2011) 334 ITR 145 (Bom.).* The important principles relating to provisions of S.50C laid down by the Courts while upholding the Constitutional Validity of S. 50C are as under:

a. Section 50C is only a standard of measure for computation of the tax which is chargeable u/s. 4 and 5 of I.T. Act.

b. A complete full proof safeguard has been given to the assessee to establish before the authorities concerned the real value under sub-section (2) of Section 50C. Hence, Section 50C deals with real value which is to be determined only after hearing the assessee as per the statutory provisions.

c. The provisions of S.50C cannot be read down as assessee has been given an opportunity to rebut the presumption as to the fair market value of the capital asset arrived at by the authorities under the Stamp Act. Hence, the ratio of decisions of Supreme Court in *K.P. Varghese vs. ITO (1981) 131 ITR 597* is not applicable to S.50C.

3.2 The above principles are important for dealing with various issues emerging u/s. 50C.

4. Applicability of S/50C to rights in land/buildings

4.1 To determine applicability of Section 50C to rights in land and building, would require interpretation of the words "transfer by an assessee of capital asset, being land or building or both" as contained in sub-section (1) of Section 50C. The term capital asset is defined in S. 2(14) to mean property of any kind held by an assessee. The term property is a term of widest import and it signifies every possible interest which a person can clearly hold and enjoy other than the exceptions carved out in the section itself. Thus a plain and literal reading of sub-section (1) of Section 50C along with S. 2(4), indicates that Section 50C has restricted its application to only two kinds of capital asset i.e., land and building and has not incorporated the wide definition of capital asset which would include various rights in land and building also.

4.2 The distinction between capital asset being 'land or building or both' and any 'right in land or building or both' is well recognised under the Income-tax Act, such as S. 54D dealing with compulsory acquisition of land and building. Sub-section (1) of S. 54D provides "Subject to the .... of a capital asset, being land or building or any right in land or building ....". Hence, wherever legislature wanted to cover within its ambit both land or building as well as rights in land or building, it has specifically done so.

4.3 Land and building include bundle of rights i.e. lease hold / tenancy rights, Development rights, etc. which can be transferred without transferring ownership of land and building. However, if land and building are actually getting transferred under the garb of transfer through means of development agreements, etc. S. 50C would apply and the transaction would not be governed by the nomenclature used in the contract / Deed / Instrument of transfer but would be governed by the substance of the transactions.

Development Agreement

4.4 As per Article 5(g-a) of the Maharashtra Stamp Act, 1958, stamp duty on any agreement relating to giving authority or power to a promoter or a developer, by whatever name called i.e., a development agreement shall be same as stamp duty payable on conveyance. Hence, as far as the stamp Act is concerned, generally a development agreement is equated with conveyance of land and building for the purpose of levy of stamp duty. Further, even under Maharashtra Ownership of Flats Act, owner of the property as well as the developer are classified as promoters and are required to convey land and building within specified time from formation of a co-operative society.

4.5 Usually in development agreements, the owner of the land and building part with the possession of the property and also accepts consideration in cash or kind or both cash and kind. The development agreements satisfy the conditions of S. 53A of Transfer of Property Act, 1882, (TOPA) and accordingly as per the provisions of S. 2(47)(v) of the Income-tax Act, the transaction of transfer is completed. Hence, when a development agreement satisfies the conditions of transfer u/s. 2(47)(v) r.w.s. 53A of TOPA, it effectively results in transfer of land and building. Thus Section 50C would be applicable to such development agreements.

4.6 Before the Hon'ble Mumbai Tribunal in *Chiranjeevlal Khanna vs. ITO ITA No. 6170/M/2008 dated 23-4-2011* it was argued by the assessee who was the owner of land and building and

had entered into development agreement that S. 50C is not applicable to transfer of rights in land and building. The Hon'ble Tribunal on perusal of the development agreement came to the conclusion that what was really transferred by virtue of the development agreement was not merely rights in land and building but the land and building itself and hence, S. 50C was applicable. Also, the Mumbai Tribunal in *Arif Akhtar Hussain vs. ITO, (2011) 140 TTJ 413 (Mum.)* held that on facts the development agreement resulted into deemed transfer of land and building by virtue of S. 2(47)(v) of IT Act r.w. S. 53A of the TOPA and hence Section 50C was applicable. It was further held that continuance of name of assessee (Owner) in the Municipal records and Property Registration card as owner after entering into the development agreement would not make my difference.

Loading of TDR /DRC/FSI by entering in development agreement

4.7 As per Regulation 34 of DCR, 1991, applicable to Greater Mumbai, development potential of land is separated from the land and is made available to the owner of the land in the form of TDR. Appendix VII of the DCR, 1991 provides the circumstances when such Development rights are made available to owners [such as surrender of land to Govt. for road widening, etc.] as well as provides for utilisation of such TDR on plot vacant or developed or by construction of additional floors subject to FSI available under regulation14 of the said Appendix. Hence by virtue of DCR, 1991, several Societies of receiving plot got the right to construct additional floors by loading TDR. The Mumbai Tribunal in *Maheshwar Prakash – 2 Co-op Housing Soc vs. ITO (2009) 313 ITR (AT) 103* held that where society enter into agreement with Developer whereby developer has to purchase TDR at his own cost and load the same on the property of the society for constructing additional floors, what was transferred is the right to construct which right came into existence due to coming into force of DCR 1991 and such right had no envisigable cost and hence such transfer of right was outside the ambit of S. 45. Similar view is taken in *Jethalal D. Mehta vs. Deputy CIT (2005) 2 SOT 422 (Mum.), ITO vs. Lotia Court Co-operative Hsg. Soc. (2008) 118 TTJ 199 (Mum.), New Shailaja Co-operative Hsg. Soc. Ltd. vs. ITO (2009) 121 TTJ 62 (Mum.)* and *Om Shanti Co-operative Hsg. Soc. Ltd. vs. ITO ITA No. 2550/M/2008, dtd. 28th August, 2009 (ITAT-Mumbai) Land Breeze Co-operative Housing Society Ltd. vs. ITO (2013) 55 SOT 103 (Mum.) (Trib.)*

4.8 Hence, where development agreements are entered for loading TDR and making additional construction, consideration received is not exigible to capital gains u/s. 45 and consequently Section 50C shall not be applicable.

4.9 It is pertinent to note that in all the above cases the Hon'ble ITAT had given a finding of fact that land and building was not transferred by the societies. Hence, Tribunal in Chiranjeev Lal Khanna (supra) after considering all these decisions held that, on fact, these decisions were distinguishable and Section 50C was applicable to transfer of development rights.

Sale of TDR/FSI/DRC

4.10 The Mumbai Tribunal in *ITO vs. Prem Rattan Gupta ITA No.5803/M/2009 A.Y. 2006-07 dated 28-3-2012* held that value of consideration received on transfer of TDR / additional FSI granted on account of land acquisition cannot be subject matter of S.50C as there is no transfer of land and building. The said decision was rendered after considering the decision of Bombay High Court in the case of *Chedda Housing Development vs. Banijan Sheikh Farid 2007 (3) MLJ 402* in which their Lordships have held that TDR is an immovable property.

4.11 Similarly under DCR, 1991 TDR is generated by virtue of Regulation 67 dealing with Heritage regulations, wherein TDR is given as compensation which can be assigned / utilised in the same ward. Assignment of such TDR will not attract S. 50C as even though they

may be regarded as immovable property but they cannot be regarded as land and building. Under DCR, 1991 incentive FSI is available for implementation of various redevelopment scheme for dilapidated buildings [Reg. 33(7)] for Slums [Reg. 33(10)], etc. Such incentive FSI as per the schemes, can be assigned and loaded on various other plots and buildings. Transfer of such incentive FSI would also not attract S. 50C as there is no transfer of land and building.

Leasehold / Tenancy Rights

4.12 The Hon'ble ITAT in *Atul G. Puranik vs. ITO (2011) 132 ITD 499 (Mum.)* has held that S. 50C is not applicable to assignment of lease hold rights. In this case the assessee had transferred lease right for sixty years in the plot. Similarly in *DCIT vs. Tejinder Singh ITA No. 1`459/Kol./2011 dated 29-2-2012,* Assessee had transferred lease hold rights for 99 years in a house property. It was held that "Lease hold right in land & building" cannot be equated with the "land and building" and accordingly Section 50C was not applicable. In *Kishori Sharad Giatonde vs. ITO ITA No. 1561/M/09 dated 27-11-2009* the assessee a tenant in flat had sold tenancy rights. The Tribunal held that Section 50C was not applicable to sale of such tenancy rights.

4.13 The Mumbai bench of the Tribunal in *ITO vs. M/s. Pradeep Steel Re-rolling Mills Pvt. Ltd. in ITA No. 341/M/2010 dtd. 15-7-2011* held that provision of S. 27(iiib) which says that a person shall be deemed owner of the building if such person acquire any rights with respect to a building by virtue of a transaction referred to in S. 269UA(f) i.e. lease of more than 12 years, etc, shall not extend to computation of capital gains and accordingly Section 50C is not applicable to transfer of such lease hold rights.

4.14 However, in *Shavo Norgren (P) Ltd. vs. DCIT (2013) 58 SOT 23 (Mum.)* it was held on facts, that *prima facie* S.50C was applicable to the lease hold rights Assessee had taken a plot of land on lease from MIDC for 95 years from 1-11-1967 which lease hold rights were assigned by assessee on 9-4-2007 and constructed building thereon. The Tribunal held that on perusal of the Assignment Agreement it was clear that even rights in building were transferred along with rights in plot. Further assessee also had development rights which were transferred along with the lease. The Tribunal ultimately restored the issue to the file of A.O. for fresh examination on the issue of application of Section 50C to the facts of the case. This decision was rendered after following the above referred decision on lease hold rights but the facts were found to be different.

Booking right

4.15 In *ITO vs. Yasin Moosa Godil (2012) 72 DTR 167 (Ahd.) (Trib.)* assessee had transferred booking rights in the flat by a tripartite agreement between assessee, developer and new buyer. The Tribunal held that Section 50C was not applicable to booking rights in land or building.

5. Applicability of Section 50C in case of transfer of capital asset by a person to a firm, etc. under Section 45(3)

5.1 As per S. 45(3), profits and gains arising from the transfer of a capital asset by a person to a firm or other AOP or BOI by way of capital contribution shall be chargeable to tax as his income of the P.Y. when such transfer takes place. Further S.45(3) states that for the purposes of S.48 amount recorded in the books of the firm shall be deemed to be the full value of consideration received or accruing as a result of the transfer of capital asset. Thus where a partner makes his capital contribution to the firm in form of land or building or both, then as per Section 45(3) amount recorded in the books of the firm shall be deemed to be the full value of consideration for the purposes of Section 48. The issue arises whether stamp duty valuation as per Section 50C(1) can be substituted for full value of consideration u/s. 45(3) instead of amount recorded in the books of the firm i.e.,

in other words whether S.50C is applicable to computation of capital gains arising of U/s.45(3).

5.2 This issue came up for consideration before the Lucknow Bench of Hon'ble ITAT in the case of *Carlton Hotel P. Ltd. vs. ACIT (2009) 122 TTJ 515.* In this case assessee had contributed 2,40,00,000 sq. ft. of land as its capital contribution to the firm through book entries and the same was valued and recorded by the partnership firm in its books at ` 7,81,96,753. A.O. invoked Section 50C and applied DM circle rates for calculating the sale consideration u/s. 45(3). It was held by the Tribunal as under:

a) Section 50C can be invoked only when the property transferred is registered and for that purpose value is assessed and stamp duty is paid.

b) Section 45(3) creates a fiction by deeming the value of a capital asset recorded in books of the firm being a transfer by the partner. The said fiction was created, as prior to introduction of Section 45(3) w.e.f. 1-4-1998, there were certain court decisions which held that capital contribution of assets by partner to firm did not amount to transfer.

c) S. 45(3) and S. 50C operate in different spheres S. 50C is invoked when there is registration of transfer and stamp duty is paid. When a transfer covered u/s. 45(3) is sought to be registered by the firm and stamp duty is paid then provisions of S. 50C can alone be invoked and S. 45(3) will not apply. S. 50C overrides S. 45(3). S. 50C is a Special provision and S. 45(3) is a general provision.

d) As the transfer was by book entry, S. 50C was not applicable.

The above decision was rendered for A.Y. 2004-05. However, w.e.f. 1-10-2009, even if the document is not registered or value is not assessed by stamp valuation authority, S. 50C is applicable. Hence where transaction takes place after 1-10-2009, then S. 50C will be applicable to S. 45(3) even if the transfer is not registered.

5.3 The above decision requires reconsideration with regard to its finding that S.50C will override S. 45(3). Though S. 50C is a Special Provision dealing with land and building, it is not a "notwithstanding" provision to override other provisions of the I.T. Act. Further, even S. 45(3) is a special provision dealing with a particular situation and cannot be taken as a general provision. Legal fiction u/s. 45(3) as well as under S. 50C is created for determining sale consideration and hence they run in same spheres. Hence, there is conflict in application of these two legal fictions in a given case simultaneously as it results in supposition on other supposition of law which is not warranted or supported by the language of the relevant provisions and to do so is impermissible in law.

6. Applicability of S. 50C to computation of capital gains u/s.50 on transfer of depreciable assets

6.1 The field on this issue is held by the Special Bench decision in the case of *ITO vs. United Marine Academy (2011) 130 ITD 113 (Mum)* wherein it is held that provisions of S. 50C are applicable to transfer of depreciable capital asset covered by S. 50. According to the tribunal, legal fiction created u/s. 50C is for "full value of consideration" and legal fiction created u/s. 50 is for "cost of acquisition". Hence, both the legal fictions operate in different fields and do no conflict with each other.

6.2 However even after the decision of Special Bench in United Marine Academy (supra) an important issue arises as to the stage at which S. 50C is to be invoked i.e. at the time of ascertaining the "excess" of net sale consideration over the depreciable value of the block u/s. 50 or after such "excess" is ascertained.

6.3 As per S. 43(6)(c), written down value in case of block of assets shall be the opening WDV

of the block as adjusted by actual cost of asset purchased during the previous year and reduced by moneys payable in respect of any asset falling within that block which is sold during the previous year. As per Explanation 4 to S. 43(6)(c), the expressions "moneys payable" and "sold" shall have the same meanings as given in Explanation below sub section (4) of section 41. As per the said Explanation "moneys payable" inrespect of any building etc when it is sold is the price for which it is sold i.e., the actual sale consideration.

6.4 Now, section 50 deems the excess of net sale consideration over opening WDV and the cost of new asset added to the block as short term capital gains. On a co-joint reading of S. 43(6)(c) and S. 50, it can be concluded that at the time of ascertaining the excess, only the actual value of consideration received or accruing as a result of sale should be considered without regard to the deeming provision of S. 50C. Thus, once there is such excess, then and only then S. 48 gets triggered and consequently S. 50C would become applicable.

6.5 It may be noted that before the Special Bench, assessee had argued for the first time that the block had not ceased to exist and there was positive WDV as per S. 43(6)(c). However, the special bench of the Hon'ble ITAT did not adjudicate this point as assessee had himself accepted below the lower authorities that the block had ceased to exist. Hence, the issue as stated aforesaid has not been determined by the Special Bench.

6.6 Further, where all assets are transferred and the block ceases to exist, then as per S. 50(2) there is no requirement of existence of any "excess" and consequently provisions of S. 48, 49 and 50C would be applicable.

7. Applicability of S. 50C to Slump sale u/s. 50B

7.1 S. 50B applies to transfer of capital asset being an undertaking or division. Hence, the capital asset in the context of S.50B is of a unique nature as it encompasses both assets and liabilities of the undertaking, i.e., the undertaking as a capital asset means "All assets minus all liabilities" of the undertaking whereas S. 50C applies to transfer of capital asset being land or building or both and does not extend to capital asset being an undertaking or division.

7.2 The Special Bench of ITAT at Mumbai in *Dy. CIT vs. Summit Securities Ltd. (2012) 135 ITD 99* has held that Explanation 2 to Section 2 (42C) defining "Slump Sale" has made it clear that the determination of the value of asset or liability for the purposes of payment of Stamp Duty, etc., shall not be regarded as assignment of values to individual assets or liabilities. It is, therefore manifest that even if the assets of the undertaking which is subject matter of transfer, include land or building or both, the stamp value shall be ignored in so far as the computation of full value of consideration of the undertaking as a whole is concerned. Neither in S. 50B or in S. 48 it is provided that the 'fair market value' of the undertaking shall be treated as the full value of the consideration received or accruing as a result of its transfer under Slump sale. Hence, S.50C is not applicable for computing capital gains u/s. 50B.

8. Applicability of S. 50C to exemptions u/ss. 54, 54F, 54EC, etc.

8.1 The provisions of the Income-tax Act granting exemption from capital gains are contained in S. 54, S. 54F, S. 54D, S. 54EC, S. 54G and S. 54GA. The exemption is available on the basis of investment of capital gains in new asset except S. 54F where exemption is based on investment of net consideration.

8.2 If S. 50C is applicable to the exemption provisions, then assessee would be expected to do the impossible i.e. make investment of notional capital gains computed by applying S. 50C for claiming the exemption. However, if S. 50C does not apply then the issue arises whether exemption computed on the basis of

sale consideration without applying S. 50 would be restricted to capital gains computed without applying S. 50C or would apply to entire capital gains computed after applying S. 50C.

Illustration

Net sale consideration	` 10,00,000
Indexed cost of acquisition	` 5,00,000
Stamp Duty value	` 20,00,000
Capital Gains (after applying S. 50C)	` 15,00,000
Capital Gains (without applying S. 50C)	` 5,00,000

Now, if cost of new asset is ` 6,00,000/- then entire capital gains of ` 5,00,000/- (without applying S. 50C) stand invested in new asset. The issue then is whether entire capital gains of ` 15,00,000/- will be exempt or only capital gains of ` 5,00,000 will be exempt.

8.3 In *Prakash Karnawat vs. ITO (2012) 49 SOT 160 (Jp),* it was held that S. 50C is not applicable to S. 54EC. In this case, the entire capital gains calculated without application of S. 50C was invested. It was held that entire capital gains calculated after applying S. 50C was exempt as entire capital gains was invested as per S. 54EC. Hence, exemption was not restricted to capital gains computed without imposing S. 50C. Similarly in *Gyan Chand Batra vs. ITO (2010) 133 TTJ (Jp) 482,* it is held that if entire sale consideration without applying S. 50C is applied for buying new asset as per S. 54F, then entire capital gains calculated after applying S. 50C shall be exempted.

8.4 In *Gouli Mahadevappa vs. ITO (2011) 128 ITD 503 (Bang),* it was held that S. 50C is not applicable to S. 54F. However, after giving effect to S. 54F, the capital gains which will be exempt u/s. 54F shall be the capital gains calculated without applying S. 50C and not the capital gains after applying S. 50C.

8.5 The above decision of Bengaluru tribunal in Gouli Mahadevappa (supra) was challenged by the assessee before the Karnataka High Court. The Karnataka High Court reversed the decision of the ITAT and adopted the methodology of the AO and CIT(A) who had applied S. 50C to S. 54F and allowed the investment in new capital asset as a deduction. The High Court also observed that the assessee had not disputed the stamp valuation u/s. 50C(2) and hence the stamp valuation had become final. The High Court further granted benefit of investment made out of moneys from other sources against the addition on notional basis made u/s. 50C.

8.6 It may be noted that, the issue of applicability of S. 50C to S. 54F as well as the issue whether relief u/s. 54F is limited to the disclosed consideration without giving benefit to the addition u/s. 50C had not been specifically dealt with by the High Court and these were also not the substantial questions of law framed by the High Court.

8.7 The best way forward in case of genuine transactions would be to exercise the right of referring the valuation u/s. 50C(2) so that the deemed sale consideration u/s. 50C is same as disclosed consideration or at least the difference between the two is minimal.

9. Applicability of S. 50C to stock-in-trade

9.1 The Madras High Court in *CIT vs. Thiruvengadam Investments P. Ltd. (2010) 320 ITR 345* has held that provisions of S. 50C is applicable only to ascertain the true value of capital asset and is not applicable to business assets i.e. stock-in-trade. The Madras High Court also affirmed the decision of Mumbai bench of the Tribunal in *Inderlok Hotel (P) Ltd vs. ITO (2009) 122 TTJ (145)* which held that S. 50C cannot be applied for determining business income. Similar view is also taken by the High Court of Allahabad in *CIT vs. Kan Construction and Colonizers (P) Ltd (2012) 208 Taxmann 478* and *Gujarat High Court in CIT vs. Mukesh & Kishor Barot Co-owner (2013) 215 Taxmann 151.*

9.2 By Finance Act, 2013, with effect from 1-4-2014, section 43CA has been inserted in Chapter IV dealing with computation of Business

Income. Under S. 43CA, stamp duty value is deemed to be full value of consideration for computing profit and gains from transfer of business asset being land or building or both. Hence, before 1-4-2014, S. 50C cannot apply to stock-in-trade and S. 43CA is applicable only from 1-4-2014.

9.3 S. 92BA inserted by Finance Act 2012 w.e.f. 1-4-2013 gives powers to A.O. to enhance business profits in cases of "specified domestic transactions". The Delhi High Court in *CIT vs. Discovery Estates P. Ltd. (2013) 356 ITR 159* has held that provisions of S. 92BA are prospective and applicable only from 1-4-2013. Hence, even S. 92BA cannot be invoked prior to 1-4-2013 to enhance the business profit on sale of land and building.

10. Applicability of S. 50C to S. 69, S. 69A, etc. unexplained investments in the hands of buyer

10.1 As per S. 50C(1), stamp valuation is deemed as the full value of consideration received or accrued as result of transfer and it nowhere provides that such value is the actual consideration passed on by the buyer to the seller. The Delhi High Court in *CIT vs. Khoob Surat Resorts (P.) Ltd (2013) 256 CTR 371* has held that stamp valuation adopted u/s. 50C cannot if so facto be a legitimate ground for concluding that there was an under valuation in the acquisition of immovable property and consequently no addition can be made in the hands of the buyer u/s. 69B. It held that such stamp duty valuation can only be a starting point for inquiry like analysing comparable sales, etc. In *ITO vs. Mrs. Inderjit Kaur (2012) 50 SOT 377 (Chd.) (Tri.)* it was held that legal fiction u/s. 50C does not extend to S. 69. Similar view is held by the Punjab and Haryana High Court in *CIT vs. Chandni Buchar (2010) 323 ITR 510.* Hence, S. 50C is not applicable to assessment of income in the hands of the buyer u/s. 69, S. 69B etc.

10.2 However, with effect from 1-4-2014, where buyer being an individual or a HUF receives any immovable property for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration shall be taxed in the hands of the buyer as per S. 56(2)(vii).

10.3 Thus, the same income will now be taxed both in the hands of the buyer and the seller. The Bombay High Court in *Walchand & Co. P. Ltd. vs. CIT (1993) 204 ITR 146 (Bom.)* after considering the Supreme Court decision in *Laxmipat Singhania vs. CIT (1969) 72 ITR 291* held that, where the legislative intent is clear, even if it amounts to double taxation, there is no absolute bar or prohibition against it.

11. Applicability of S. 50C to documents not registered

11.1 Provisions of S. 50C require adoption of value determined by stamp valuation authorities as full value of consideration received or accruing as a result of transfer of land or building or both. Hence, unless a sale agreement/transfer document is registered and stamp duty is assessed, S. 50C cannot be invoked. This legal position is stated in *Carton Hotel (P) Ltd vs. ACIT (2009) 122 TTJ (Luck) 515, Navneet Kumar Thakkar vs. ITO (2007) 112 TTJ (JD) 76* and *Ranmal Bhansali vs. ACIT (2012) 143 TTJ (Del) (UO) 65.*

11.2 With effect from 1-10-2009, Finance (No. 2) Act, 2009 inserted the words "or assessable" in S. 50C whereby transfers of properties without or before registration can also be subjected to provisions of S. 50C. Hence after introduction of the words "or assessable" such transfers where the value is assessable by the valuation authority are also brought into the ambit of section 50C.

11.3. The Madras High Court in *CIT vs. R. Sugantha Ravindran (2013) 352 ITR 488* has after considering Circular No.5 of 2010, dated 3-6-2010 (2010) 324 ITR (St.) 293 held that the amendment made by Finance (No. 2) Act, 2009 is prospective in nature and cannot be applied retrospectively. Hence, the amendments have been made applicable with effect from

October 2009 and will apply only in relation to transactions undertaken in or after such date.

12. Applicability of S. 50C to sale of shares of a company where such company is the owner of land and building

In *Irfan Abdul Kader Fazlani vs. ACIT (2013) 56 SOT 12 (Mum.)* it was held that S. 50C applies only to the transfer of a "capital asset, being land or building or both", "assessed" by any authority of a State Government for stamp duty purposes. The expression "transfer" has to be a direct transfer as defined u/s 2(47) which does not include the tax planning adopted by the assessee. S. 50C is a deeming provisions and has to be interpreted strictly in accordance with the spirit of the provision. On facts, the subject matter of transfer is shares in a company and not land or building or both. The assessee did not have full ownership on the flats which are owned by the company. The transfer of shares was never a part of the assessment of the Stamp Duty Authorities of the State Government. Also, the company was deriving income which was taxable under the head 'income from property' for more than a decade. Consequently, the action of the AO & CIT(A) to invoke s. 50C was held to be not proper and did not have the sanction of the provisions of the Act.

13. Reference to valuation officer – S. 50C(2)

13.1 Section 50C(1) – deems / presumes stamp valuation as sale consideration. However, this presumption is a rebuttable one at the option of the assessee. As per s. 50C(2) where assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority u/s.50C(1) exceeds the F.M.V. of the property as on the date of transfer and the valuation adopted or assessed or assessable by the stamp valuation authority is not disputed in any appeal or revision or no reference has been made before any other authority court or the High Court then the Assessing Officer may refer the valuation of the capital asset to Departmental valuation officer.

13.2 Under S. 50C(2), the onus to show that stamp valuation is not the Fair market value is on the assessee and hence it is necessary for the assessee to specifically dispute the stamp valuation before the Assessing Officer. Hence, provisions of S. 50C(2) has to be invoked by the Assessee as held in *Sanjaybhai Z. Patel vs. ACIT (2011) 48 SOT 231 (Ahd.)* and *Ambattur Clothing Co. Ltd. vs. ACIT (2010) 326 ITR 248 (Mad.) Though S.50C(2)* does not lay down any specific mode in which the stamp valuation is to be disputed, it is better to have valuation done by an independent registered valuer for disputing the stamp valuation. A.O. is not an expert in valuation as held in *Ajmal Fragrances and Fashions P. Ltd. vs. ACIT (2009) 34 SOT 57 (Mum.)* and hence, it is incumbent upon the A.O. to refer the valuation to departmental valuation officer. The word "may" used in S. 50C(2) should be treated as "shall" once the assessee objects to the stamp duty value as held in *A.T.E Enterprises P. Ltd. vs. Dy. CIT (2013) 55 SOT 175 (Mum.)(Trib.).*

13.3 On a co-joint reading of S. 50C and S. 16A of Wealth Tax Act, the Department valuation report is binding on the Assessing Officer as held in *CIT vs. Dr. Indra Swaroop Bhatnagar (2012) 349 ITR 210 (All.) (HC)* and *Bharat Jayesh Sangani vs. ITO (2011) 128 ITD 345 (Mum.)* and hence where the valuation by DVO is less than stamp valuation it will not be open to the A.O. to take stamp value as sale consideration. As per S. 50C(3), if value of DVO is more than stamp valuation, then A.O. has to adopt stamp value. However, the report of DVO is not binding on the CIT(A) as held by the Chennai Tribunal in *ACIT vs. MIL Industries Ltd. (2013) 142 ITD 428* and hence CIT(A) is fully competent to go below the valuation given by DVO. Similarly the DVO report is not binding on the ITAT and ITAT can fix a value different then the value taken by the DVO as held by the Mumbai Bench of the ITAT in *Abbas T. Reshamwala vs. ITO, ITA No. 892/M/2012, dated 20-2-2013.*

13.4 In *ITO vs. Gita Roy (2012) 135 ITD 345 (Kol.) A.O.* adopted the stamp valuation and had made no reference to DVO. Before CIT(A), assessee raised several grounds to object the stamp valuation. After calling for the remand report, CIT(A) referred the matter to the DVO and after receiving the report of DVO directed the A.O. to adopt the value of the property sold as per DVO report. The Tribunal upheld the order of CIT(A) whereby CIT(A) made reference to DVO and directed the A.O. to adopt the value of DVO. Hence, reference to DVO can be made by the CIT(A) also.

13.5 The Madras High Court in *N. Meenakshi vs. ACIT (2010) 326 ITR 229* entertained the writ petition and set aside the order of the A.O. adopting stamp valuation during the pendency of report from DVO as the assessment was getting time barred. The court held that a writ was maintainable as S. 50C(2) grants statutory protection to the assessee and extended the time limit for completing assessment after receiving report from DVO. Sometimes, A.O. adopts stamp valuation u/s. 50C subject to DVO report where assessments are getting time bared. In such cases remedy u/s. 154 can be invoked. Where assessee does not file a writ petition, assessee can either place reliance or dispute the DVO report at the appellate stage also.

14. Position when stamp duty value is contested under stamp duty law / challenged in court

14.1 As per S. 155(15), where capital gain is computed by adopting stamp valuation u/s.50C(1) and such value is revised in any appeal or revision or reference referred to in S .50C(2)(b), the Assessing officer shall amend the order of assessment to adopt the revised value by applying the provisions of section 154 and the period of four years shall be reckoned from the end of the previous year in which the order revising the value was passed in appeal or revision or reference.

14.2 The above scheme of implementing S. 50C is harsh as the seller will have to bear assessment at stamp valuation and wait till the stamp valuation issue is decided in the case of the buyer. It would have been better if assessment is made on the basis of actual sale consideration till the stamp valuation issue is decided in the case of the buyer.

15. Whether stamp duty value as on date of agreement to sell or date of registration of Sale Deed to be adopted for S. 50C

15.1 S. 50C is not the charging section. Hence, it can be applied only when there is a transfer within the meaning of I.T. Act.

15.2 In a transaction for sale of land or building or both, usually parties enter into an agreement to sell where the consideration is fixed and transfer is completed subject to fulfilment of certain requisitions within a stipulated time, after which a registered Sale Deed is executed. Possession may or may not be parted with at the time of such agreement to sell. However, where the possession is parted with, it results into a deemed transfer under the Stamp Act and stamp duty becomes payable. Similarly, it may amount to transfer u/sec. 2(47)(v) which considers transactions satisfying condition of S. 53A of the Transfer of Property Act, 1882 as transfer and therefore executing a registered Sale Deed becomes a mere formality to consider the legal ownership.

15.3 As per the newly introduced S. 43CA and S. 56(2)(vii), where the date of agreement fixing the value of consideration for transfer of the asset and date of registration of such transfer of asset are not the same, stamp duty value assessable on the date of agreement shall be the full value of consideration received or accruing as a result of such transfer. Thus, an agreement fixing value of consideration for transfer of property will be relevant and not the ultimate date of registration for S. 43CA. Similar provision is not contained in S. 50C.

15.4 U/s. 50C, the term "assessable" has been introduced from 1-10-2009 to cover transaction

of transfer before their registration or where they are not registered. Hence, after 1-10-2009, it appears that if there is a transfer under sec. 2(47) at the time of entering into agreement to sell, the stamp duty value assessable on the date of such transfer has to be adopted for determining the full value of consideration and not the stamp duty value ultimately assessed by the Stamp Valuation Authority on the date of registration. Thus, to the extent, that an Agreement fixing value of consideration of transfer also results into transfer as per S. 2(47), the effect of provision of S.50C will be similar to that of S. 43CA and S. 56(2)(vii). However, where the agreement to sell does not result into transfer as defined u/s. 2(47), the stamp duty value assessable on the date of registration will have to be taken for the purposes of Section 50C(1).

15.5 In *DCIT vs. Venkat Reddy (2013) 57 SOT 117 (Hyd.),* Agreement of Sale was entered into on 13-6-2005 for ` 2,75,00,000/- and possession was parted with on the same day. The Sale Deed was finally registered on 25-11-2005 and the market value for the stamp duty was ` 4,30,70,000/-. The SRO value as on 25-11-2005 was ` 8,000/- per sq. yd. whereas SRO value as on 13-6-2005 was ` 4,800/- per sq.yd. A.O. adopted the stamp valuation on date of registration u/s.50C and completed the assessment. The C.I.T.(A) held that transfer took place on 13-6-2005 and hence invoking S. 50C in the facts of the case was improper. The Tribunal held that under the common law, the date of execution of Sale Deed is taken as date of sale but under the Income Tax Act, transfer can take place on the date of Agreement to Sell in terms of S. 2(47)(v). As, S. 50C is applicable on registration of Sale Deed, assessee can dispute the same u/s. 50C(2). The Tribunal ultimately held that as the execution of Sale Deed was only a legal formality as transfer was completed on 13-6-2005, A.O. was directed to adopt the SRO value as on the date of agreement to sell. This decision as rendered before the introduction of the term "assessable" in S. 50C.

15.6 In B*agri Impex (P) Ltd., vs. ACIT (2013) 214 Taxman 305 (Cal.)(H.C.),* Agreement to Sale was entered on 15-10-1996 (A.Y.1997-98), assessee received balance consideration in A.Y. 2006-07, conveyance was executed on 26-5-2006 (A.Y. 2007-08)and registered on 27-11-2007 (A.Y. 2008-09) on which date stamp duty was assessed. Assessee offered sale proceeds for taxation during A.Y. 2006-07. According to Assessee as sale took place in A.Y. 2006-07, S. 50C is not applicable as A.O. has no power to adopt "assessable" stamp valuation in A.Y. 2006-07 as such power is available only after 1-10-2009. The High Court held that assessee had himself not followed the provisions of S. 2(47)(v). It further held that S. 50C would be applicable in A.Y. 2006-07 as A.O. while making assessment had the stamp valuation before it. The amendment made in 2009 may have made the things simple. By adopting devices to defeat the provisions, assessee cannot be heard to say that S. 50C is not applicable.

15.7 Hence, post the amendment of 2009, stamp duty value assessed or assessable as on the date of agreement to sell if it results into transfer has to be taken for determining the full value of consideration u/s. 50C. Prior to the amendment also, if there is an agreement to sell coupled with possession satisfying the conditions of transfer u/s. 2(47)(v) and capital gains is offered in the year of such transfer then stamp valuation available on the date of registration can be adjusted to the date of agreement to sell by exercising the provisions of S. 50C(2).

16. Penalty u/s. 271(1)(c) in case of addition u/s. 50C.

16.1 In C*IT vs. Madan Theatres (2013) 260 CTR 75 (Cal) (HC)* assessee had sold the property at ` 2,51,50,000/- and computed capital gains in its computation of income by taking sale consideration at ` 2,51,50,000/-. The Assessing Officer fixed the sale price at stamp duty value of ` 5,19,77,000/- u/s. 50C and initiated penalty proceedings u/s. 271(1)(c). Assessee chose not to contest the stamp duty value u/s. 50C(2) as

there was difference in the tax liability. Before the High Court it was argued by the revenue that as assessee did not dispute the stamp valuation before the Assessing Officer, penalty is leviable u/s. 271(1)(c). The High Court held that revenue failed to produce an iota of evidence to show that assessee actually received one paisa more than the amount shown to have been recived by him and that the proceedings u/s. 271(1)(c) started only on the basis of deemed consideration. Thus, the High Court confirmed the order of the Hon'ble ITAT which had deleted the penalty u/s. 271(1)(c).

16.2 In *Shri Chimanlal Manilal Patel vs. ACIT ITA No. 508/Ahd/2010 dated 22-6-2012* (ITAT – Ahmedbad) assessee in response to notice u/s. 148, filed revised return offering sales consideration on sale of land as per the provisions of S. 50C. A.O. initiated penalty proceedings u/s. 271(1)(c) on the ground that assessee had not shown capital gains as per provisions of S. 50C in the original return of income. The Hon'ble ITAT held that A.O. had not disputed the consideration received by the assessee and had not doubted the genuineness of documents/details furnished by the assessee. Assessee agreeing to addition on the basis of deemed provisions cannot be construed as filing of inaccurate particulars of income. Accordingly penalty was deleted.

16.3 In *Renu Hingorani vs. ACIT ITA No. 2210/M/2010* dated (ITAT-Mumbai), assessee had agreed to stamp duty valuation u/s. 50C during assessment proceedings. A.O. consequently initiated penalty u/s. 271(1)(c). The Hon'ble ITAT held that A.O. had not questioned the actual sale consideration and addition was made only on the basis of deeming provision of the Income tax Act. Consequently, penalty levied u/s. 271(1)(c) was deleted by the Hon'ble ITAT. Similarly, penalty u/s. 271(1)(c) on additions u/s. 50C agreed by the assessee are deleted by the Chennai bench of the Tribunal in *ACIT vs. Mrs. N. Meenakshi (2009) 125 TTJ (Chennai) 856* and Jodhpur bench of the Tribunal in *Prakashchand Nahar vs. ITO (2007) 110 TTJ (Jd.) 886*

16.4 It may be noted that, all the above cases mainly relate to the situation where assessee accepted stamp valuation and A.O. could not bring anything on record to show that assessee received anything more than what is declared in the sale Agreement. However, where DVO report is called for which after considering comparable sale transactions, etc. value the property more than the sale consideration a case may be made out on circumstantial evidence that assessee might have received consideration over and above the declared consideration and the said extra consideration is concealed by the assessee. In such situations, it would be helpful to avoid penalty if valuation from a registered valuer supports the declared sale consideration.

17. Conclusion

Prevention is better than cure. From the above discussion it emanates that there are several intricate legal issues arising u/s. 50C which can be decided either way. It is well known that stamp valuation authorities adopt the Ready Reckoner rates and do not compute the fair market value. Whenever such rates are more than the prevailing ground reality, Assessee must obtain registered valuers report to justify the actual sale consideration before the filing of the Return of Income and also intimate the department that actual sale consideration is adopted in the computation of Income which is justified by the registered valuers report. Recently, the Allahabad High Court in *CIT vs. Chandra Narain Chaudhri ITA No. 287 of 2011* dtd. *29-8-2013* has held that the A.O. has to consider, the registered valuers report before making reference to the Department valuation officer. Hence, such preventive steps will go a long way to save assessee from penalty as well as any adverse decision on the legal issues involved u/s.50C.

CA Ketan Vajani

Exemptions from Capital Gains – Sections 54, 54F and 54EC

As a fundamental principle of taxation, any kind of capital receipts by an assessee is not considered as Income and the same cannot subject to tax. However, section 2(24)(vi) provides that any capital gains chargeable under section 45 of the Income-tax Act are to be included as income. Accordingly the capital gains chargeable under section 45 are made liable to tax though they are by definition capital receipts. The Chapter IV-E of the Income-tax Act contains sections 45 to 55A dealing with the ever controversial and ever interesting topic of "Capital Gains". The Special Story of this issue is befittingly dealing with this evergreen topic in which always there are various doubts in the minds of both the assessee and also tax-professionals. Though there are numerous decisions of the courts on each issue, the decisions are also divergent due to peculiar facts of each case and also diverse interpretation of the provision of the statute.

No one likes to be taxed and this pinch of being taxed becomes even severe when it comes to getting taxed on capital gains for more than one reason. But then, it is said that taxes are as inevitable as death. One of the reasons that the capital gains tax is pinching is that it is a tax on inflation rather than tax on real income as the economists would understand. Thankfully there are provisions embedded in the Act granting exemptions from capital gains in various situations, especially when the capital gain is arising from transfer of a Long Term Capital Asset. These exemption provisions are very important part of the scheme of capital gains taxation since it brings a level playing field to a certain extent between the Crown and the Subject.

This article proposes to deal with some of the ever faced yet challenging issues that arise under the provisions of Section 54, Section 54F and Section 54EC of the Act. The provisions of these sections are known to the esteemed readers of this journal to a considerable extent and hence it may not be necessary to deal with the provisions. It would be rather beneficial to have an analytical look at various issues that arise on almost daily basis in a professional's life.

Issues arising under section 54 and section 54F of the Income-tax Act, 1961

Both sections 54 and 54F of the Act provide for exemption from long term capital gains on purchase or construction of a residential house by an assessee. Whereas section 54 grants exemption from capital gains arising on transfer of a residential house, section 54F grants similar exemption from capital gains arising on transfer of any capital asset other than a residential house. The broad scheme of exemption under both the sections remains

similar to a great extent barring a few small differences. Accordingly the issues arising under both these sections can be taken together for our understanding. We shall now proceed to discuss some of such issues as under :

Investment in multiple houses

This is the most common issue being faced by the tax payers and the professionals time and again. If an assessee transfers a residential house (or other capital asset) and purchases or constructs more than one residential house, the issue always arises as to whether the exemption under both the above sections will be available in respect of investment in any one of the residential house or it will be available for both / all the residential houses newly purchased / constructed.

The controversy is centered around the interpretation of the phrase "a residential house" used for the eligible investment in both the sections. Whether the word "a" means a single unit or it means that the investment shall be made in a house which is residential in nature.

There were various views of different tribunals on the above issue and a Special Bench was constituted in the case of *ITO vs. Ms. Sushila M. Jhaveri (2007) 107 ITD 321 (Mumbai)(SB)* to answer the above question. In that case the assessee had invested the capital gains in two residential houses situated in different localities of the city and was claiming exemption in respect of both the residential houses. The Special Bench held that the assessee would be entitled to exemption in respect of investment in any one house of her choice and not for investment in both the houses situated in different localities. The Special Bench interpreted the word "a" to mean a single unit as against "any" which in the view of the special bench describes the nature of the property.

However as against the above view of the Special Bench, the Karnataka High Court in the case of *CIT vs. D. Ananda Basappa (2009) 309 ITR 329 (Kar.)* has held that the expression "a residential house" should be understood in a sense that the building should be of residential nature and "a" should not be understood to indicate a singular number. The Karnataka High Court has also referred to section 13 of the General Clauses Act to conclude that whenever the singular is used for a word, it is permissible to include the plural. In this case, one more factor which was in favour of the assessee was that the residential units were adjacent to each other and were used as one house. This decision of the Karnataka High Court has been subsequently followed in the case of *CIT vs. K. G. Rukminiamma (2011) 331 ITR 211 (Kar.)* and also *CIT vs. Syed Ali Adil (2013)352 ITR 418 (AP).*

The issue also came up before the Delhi High Court in the case of *CIT vs. Gita Duggal (2013) 357 ITR 153 (Del.).* In this case, the assessee was owner of house property with basement & two floors. She entered into agreement with a developer for developing property. As per the agreement, the assessee transferred 22.5 percent of right to developer. She declared Long Term Capital Gains and claimed exemption u/s 54/54F in respect of house on first and second floors. The Assessing Officer rejected the claim for exemption holding that they were separate and independent residential units having separate entrances and cannot be considered as one unit to enable assessee to claim deduction. The Delhi High Court considered the above decisions of Karnataka High Court and held that sections 54/54F requires assessee to acquire a "residential house". If an assessee acquires a building, which may be constructed, for sake of convenience, in such a manner as to consist of several units which can, if need arises, be conveniently and independently used as an independent residence then requirement of the section should be taken to have been satisfied. There was nothing in these sections which require residential house to be constructed in a particular manner. Only requirement is that it should be for residential use and not for commercial use. It was held that a

person may construct a house according to his plans and requirements and therefore the fact that residential house consists of several independent units could not be permitted to act as an impediment to allowance of deduction u/ss. 54/54F.

In view of the above decisions, it seems that the issue is settled at least as of now in favour of the assessee. The decision of the Special Bench in the case of Sushila M. Jhaveri has been disapproved by decisions of various High Courts. As such, it seems that there shall not be any difficulty in claiming exemption u/ss. 54 / 54F in respect of investment made in more than one residential house by the assessee.

Few offshoots of this issue are that what will be the situation where the new houses purchased are situated – (a) not adjacent but in the same building or society; (b) though adjacent but not used as a single unit; (c) in different buildings or society; (d) in totally different locality or different part of city or different city altogether.

When the houses are not adjacent to each other but say one house is on 3rd Floor and the other on 5th Floor or one house is in "A" wing and the other in "C" wing – In such a situation also there shall not be much difficulty in claiming exemption for both the houses as one can still say that the houses are used as a single unit.

Interesting issue arises where the houses are in different societies or different localities or different parts of city or different cities. Can one still say that the case will be covered in favour of the assessee in such a situation following the decisions of various High Courts as discussed above?

It is pertinent to note that in all the above decisions of the High Courts, the multiple units were used as a single residential house as a matter of fact. This fact has also been perhaps instrumental in the decision of the High Court in favour of the assessee. As of now, there is no decision of any High Court dealing with a situation where the houses were in different parts of the City or they were in different cities altogether. As against this, the decision of Special Bench in the case of Sushila M. Jhaveri was dealing with a situation where the two houses were situated in different parts of the city. Can one therefore say that in such a situation, the decision of the Special Bench still holds good and the decisions of the High Court shall be read only with reference to the facts in those cases.

The Punjab & Haryana High Court had an occasion to deal with such a situation in the case of *Pawan Arya vs. CIT (2011) 49 DTR 123 (P & H).* The High Court in this case was concerned with a claim for exemption in respect of multiple houses where one house was at Delhi and the other house was at Faridabad. The High Court has held that in such a situation the exemption can not be available for both the houses. The High Court distinguished the decision of the Karnataka High Court in the case of D. Anand Basappa and has followed the decision of the Special Bench in the case Sushila M. Jhaveri on facts of the case.

The Punjab & Harayana High Court has distinguished the decision of Karnataka High Court on facts but at the same time it has not dealt with one relevant observation of Karnataka High Court and also other High Courts that the expression "a residential house" should be understood in a sense that the building should be of residential nature and "a" should not be understood to indicate a singular number. If one reads the word "a" with respect to the word "residential" instead of the word "house" as suggested by the observation of the Karnataka High Court, then probably the result is likely to be in favour of the assessee. As such, I believe that this issue has still not reached the finality in spite of the decision of the Punjab and Haryana High Court.

Booking of under construction flat – whether purchase or construction?

Another issue which comes up for consideration is that in a case where after selling the original

asset, if the assessee books a flat in an under construction project then whether the said booking amounts to purchase of residential house or construction of the residential house. The assessee would always like to treat the booking as construction and not purchase. This is for the obvious reason that in such a scenario, the assessee would get one extra year for complying with the conditions of sections 54 or 54F. For the same reason, the department would like to treat the booking as purchase of residential house.

The booking of the flat can be considered as construction by the assessee if the terms and conditions of the agreement indicate that the builder is acting as the agent of the assessee and is constructing the house on behalf of the assessee. If, however, the stipulations are such that the builder is acting as a principal and the agreement is for sale of a constructed unit, then probably it would be slightly difficult to treat the same as construction.

In the case of *CIT vs. Smt. Bharati C. Kothari (2000) 244 ITR 352 (Cal.)*, the Calcutta High Court has taken a view that whether assessee himself constructs the house or he gets it constructed by a contractor or third party that does not make any difference. The basic requirement for purpose of relief under s. 54(1) is that the assessee should invest the sale proceeds in the construction of residential house, which has been constructed for assessee.

The Bombay High Court in the case of *CIT vs. Mrs. Hilla J. B. Wadia (1995) 216 ITR 376 (Bom.)* has held that held that the assessee was entitled to relief under s. 54 where she entered into an agreement with Co-operative Housing Society for purchase of residential flats and paid almost entire consideration within two years of conveyance of her residential property. It was observed that s. 54 will have to be construed in the context of the manner in which such residential properties are now being constructed in a city like Bombay where, looking to the cost of the land, Co-operative Housing Societies are being formed for constructing a building in which flats are allotted to members. This must also be viewed as a method of constructing residential tenements.

Similarly Mumbai Tribunal in the case of *Asst. CIT vs. Smt. Sundar Kaur Sujan Singh Gadh (2005) 3 SOT 206(Mum)*, has held that in a case where the builder has allotted the flat to the assessee by way of Letter of Allotment, it has to be taken as a construction of the residential flat and not as a purchase of residential flat.

For arriving at the above conclusion, the Tribunal has referred to the CBDT Circular No. 672 dated 16-12-1993 and also Circular No. 471 dated 15-10-1986. *Vide* Circular No. 471 the CBDT has directed that allotment of flats under the Self-Financing Scheme of the Delhi Development Authority shall be treated as cases of construction for the purpose of capital gains. Expanding the scope of the above circular, the CBDT issued circular No. 672 where it is clarified that if the terms of the schemes of allotment and construction of flats/houses by the co-operative societies or other institutions are similar to those mentioned in Circular No. 471, dated 15th October, 1986, such cases may also be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act.

Expenses incurred on construction post purchase of a house

At times it so happens that the assessee purchases a residential house and thereafter makes substantial alterations in the same with a view to make it habitable. The expenses may also be incurred by the assessee to make it comfortable as per his individual choice and needs. A question arises whether in such a situation, the exemption will also be available on the expenses incurred by the assessee on the construction / alterations or only the purchase price will be available for the purpose of the exemption?

As per the provisions of sections 54/54F, the exemption is available where the assessee has within one year before or two years after the date of transfer purchased or within three years after the date of transfer constructed a residential house. Reading the above provisions, the department contended that the assessee can either purchase or construct a residential house. It is not possible to claim exemption in respect of both purchase price as well as construction cost of the residential house and accordingly the exemption will not be available for the construction expenses incurred post purchase of the asset by the assessee. The department also contends that once the assessee purchases the flat the transaction is complete and whatever is incurred thereafter does not get covered under the provisions of section 54.

In the case of *B.B. Sarkar vs. CIT (1982) 132 ITR 150 (Cal.),* the assessee had invested part of the consideration received on transfer of a residential house in purchase of another residential house and the other part of the consideration in the construction of one more floor in said newly purchased house within periods stipulated in section 54 and had claimed exemption in relation to entire consideration invested in "purchase" and "construction". It was held that assessee was entitled to the exemption in respect of both the purchase and construction. The Calcutta High Court has observed in this case that if an assessee is entitled to relief on fulfilment of either of the two conditions of s. 54, that is to say, either purchasing a house property within one year or constructing the house within two years, it would be improper to read that on fulfilment of both the conditions, he would be disentitled to that relief.

The Mumbai Tribunal in the case of *Mrs. Gulshanbanoo R. Mukhi vs. Jt. CIT (2002) 83 ITD 649 (Mum)* has held that the expenses incurred by the assessee on the repairs to make the flat habitable will be allowable as the exemption u/s. 54 of the Act. The Tribunal has very correctly observed that the words used about the amount spent on purchase of new asset are "cost thereto" and not "price thereto". The cost includes purchase as well and accordingly the amount of purchase will include other necessary expenditure in this behalf to make a residential house habitable and taken together will be the cost of the new asset. The Mumbai Tribunal also dealt with the argument of the revenue that the transaction gets complete once the purchase is made and the subsequent expenses are not covered by section 54. For this, the Tribunal observed that unless the assessee makes payment of the purchase price to the vendor, he will not allowed to carry out the repairs and accordingly the claim cannot be denied just because the cost of repairs is incurred post the payment of purchase price. The above view of the Mumbai Tribunal has been subsequently followed in the case of *Jt. CIT vs. Smt. Armeda K. Bhaya (2005) 95 ITD 313 (Mum).*

Further in the case of *Saleem Fazelbhoy vs. DCIT (2007) 106 ITD 167 (Mum.),* the Tribunal observed that an inhabitable premises cannot be equated with a residential house. If one person cannot live in a premise, then such premises cannot be considered a residential house. In the modern age, the builder may provide semi-finished house or complete house depending upon the price agreed to between the parties. In case of semi-finished house, the purchaser will have to invest on flooring, wooden work, sanitary work, etc., to make it habitable. Therefore, the investment in house would be complete only when such house becomes habitable. Expenditure incurred on making the house habitable should be considered as investment in purchase of the house subject to the condition that payment was made during the period specified in s. 54F.

In the case of Saleem Fazelbhoy the Tribunal however also observed that there is distinction between expenditure incurred on making the house habitable and the expenditure on renovation. One may visualise a situation where

assessee may buy a habitable house but the assessee may like to incur expenditure by way of renovation to make it more comfortable. He may not be happy with the quality of material used by the builder and, therefore, he may incur the expenditure on improvement of the house. Such expenditure cannot be equated with the expenditure on making the house habitable. Whether the house purchased by the assessee was in a habitable condition or not would depend on the state of condition of the house at the time of purchase. Considering these observations, it seems that the renovation expenses incurred for refurnishing the house as per the choice of the assessee may have some difficulty in getting allowed as exemption. Here again, I believe that a habitable house is a very relative term and there cannot be any standard benchmark to decide this. What can be said to be luxury in a given case may be considered as a necessity in some other case depending on various factors like the financial or social status of the assessee in the society, the past residence of the assessee etc.

Recently the Ahmedabad Tribunal in the case of ***Srinivas R. Desai vs. ACIT (2013) 155 TTJ (Ahd.) 743*** has held that the cost of purchases does include any capital expenditure incurred on the assessee on such property to make it liveable. As long as the costs are of such a nature as would be includible in the cost of construction in the normal course, even if the assessee has bought a readymade unit and incurred those costs after so purchasing the readymade unit as per his taste and requirements, the costs so incurred will form integral part of the qualifying amount of investment in the house property. In this decision, the Tribunal also held that the use of words 'purchased or constructed' does not mean that the property can either be purchased or constructed and not a combination of both the actions. A property may have been purchased as a readymade unit but that does not restrict the buyer from incurring any *bona fide* construction expenditure on improvisation or supplementary work.

When the New Residential House can be said to be purchased/constructed

Both sections 54 and 54F allow exemption on purchase or construction of a new residential house. The purchase or construction of the new house has to be made within the prescribed time period. There are several events happening in case of purchase or construction of an immovable property. Some of these important events are (a) part payments (b) agreement (c) balance payment (d) registration (e) possession of the flat etc. A question therefore often arises as to when the new residential house can be said to be purchased or constructed. Whether it is on payment of first installment or on agreement or whether it is on registration of agreement? Whether the part payment is sufficient to say that the house is purchased or total payment is necessary? Whether the possession is necessary for the purchase transaction to be complete?

As per general principle of law an immovable property is said to be transferred when the conveyance is registered and the possession of the same is handed over to the transferee. This general principle of law however needs to be relaxed as far as the provisions of sections 54 and 54F of the Income-tax Act are concerned. This is for a valid reason that both the sections require an assessee to "purchase" or "construct" a residential house as against owning or acquiring a residential house. Accordingly, in certain situations it may so happen that on a given date, the house cannot be said to be owned by the assessee since some legal procedures are still pending. However considering various events, the purchase of the house may be complete and the exemption may be allowed.

The Supreme Court in the case of ***CIT vs. T. N. Arvinda Reddy (1979) 120 ITR 46 (SC)*** has held that the word "purchase" in section 54(1) of the Act has to be given the common meaning of the word i.e., buy for a price or equivalent of price by payment in kind or adjustment towards a debt or for other mandatory consideration. This

decision of the Supreme Court has been referred and followed in many other decisions of various High Courts.

In the case of *CIT vs. Mrs. Shahzada Begum (1988) 173 ITR 397 (AP),* the assessee has paid substantial portion of the purchase consideration and has also obtained the possession of the new residential house within the time limit prescribed under section 54. However the registration of the property was done after the period of one year. The High Court held that the expression "purchased" would undoubtedly connote the domain and control of the property given into the assessee's hands. The house property purchased by the assessee had come into the full domain and control of the assessee within the period of one year and accordingly exemption was held to be allowable.

One can also make a useful reference to the decision of the Hon. Bombay High Court in the case of *CIT vs. Dr. Laxmichand Narpal Nagda (1995) 211 ITR 804 (Bom.).* The Bombay High Court in this case has held that for the purpose of section 54 of the Income-tax Act, the word purchase is not used in the sense of a legal transfer. The High Court has also held that the ordinary meaning of the word purchase shall be adopted in absence of any definition under the Income-tax Act. While deciding the said case, the Hon'ble Court has also considered the language of section 54(2) of the Act and has held that taking into consideration that the word "towards" is used before the word "purchase" in sub-section (2) of section 54, it seems that the word "purchase" is not used in the sense of legal transfer. Though the above decision is given in context of section 54, the same can be applied to the provisions of section 54F of the Act as well. This is for the reason that the purpose and also the language of sub-section (2) of section 54 is almost similar to sub-section (4) of section 54F. The word "purchase" is also preceded by the word "towards" in sub-section (4) of section 54F.

Another supporting decision is that of the Madras Tribunal in the case of *Mrs. Seetha Subramanian vs. ACIT (1996) 59 ITD 94 (Mad.)* where it has been held that in a case where the sale proceeds of the capital assets stood invested in the construction of a residential house within the stipulated period, the assessee is entitled to exemption u/s. 54F and completion of construction or occupation is not essential.

In view of the above discussion, it can be said that the word purchase in both the sections shall be construed differently than ownership and as long as there is payment of the consideration and the assessee has acquired the domain of the property in question, the exemption shall be allowable even if legal ownership is not with the assessee.

Consequence where construction cannot be completed within the time specified

In a case where the assessee starts the process of construction of the house but could not complete the same within the specified time limit, the department is likely to take a view that the assessee has not constructed the new house within the prescribed time and hence the exemption is not allowable.

Here again, one should bear in mind that the provisions of section 54 and section 54F of the Act are beneficial provisions and the same shall be construed liberally so as to advance the object for enacting these sections. The benefit of exemption shall be granted to the assessee where the assessee has made substantial compliance of the conditions and complete compliance could not happen due to various circumstances beyond the control of the assessee.

As regards the liberal interpretation of the exemption provisions, a very useful reference can be made to the decision of the Hon'ble Supreme Court in the case of *Bajaj Tempo Ltd. vs. CIT (1992) 196 ITR 188 (SC).* In this

decision the Supreme Court has followed its earlier decisions in the case of *Broach District Co-operative Cotton Sales, Ginning & Pressing Society Ltd. vs. CIT (1989) 177 ITR 418 (SC)* and also *CIT vs. Straw Board Manufacturing Co. Ltd. (1989) 177 ITR 431 (SC).* All these decisions have consistently held that an exemption section shall be liberally construed keeping in mind the object behind the relevant section.

In the case of *CIT vs. Saradarmal Kothari (2008) 302 ITR 286 (Mad.),* the Court was considering the question of exemption u/s. 54F of the Act. The assessee in this case had made entire investment of the net consideration for purchase of the land itself for the purpose of construction but the construction of the house was completed subsequent to the specified time limit. The assessee has also produced the completion certificates from the Municipal Authorities for the construction completed later on. The Madras High Court held that for the purpose of section 54F it is not necessary that the construction should be completed within the period of 3 years. In the case before the Madras High Court the revenue has also relied on the CBDT Circular No. 667 dated 18-10-1993 for the contention that the construction needs to be completed within the specified time. However, the Madras High Court has held that the said circular would not in any way advance the case of the Revenue to come to the conclusion that in order to have the benefit under section 54F of the IT Act, the construction should have been completed. Similar view has been expressed recently by the Karnataka High Court in the case of *CIT vs. Sambandam Udaykumar (2012) 251 CTR (Kar.) 317* and also by the Hyderabad Tribunal in the case of *Smt. Pushpadevi Tibrewala vs. ITO (2013) 58 SOT 41 (Hyd.).*

Whether the Registration of the new house is essential for claiming exemption

As explained above the concept of purchase under the provisions of sections 54 and 54F is different than the concept of legal ownership and there is no requirement that the legal procedures for ownership of the new house shall be complete for the purpose of acquisition of the new residential house. Accordingly the registration of the conveyance deed is also not essential to enable the assessee to claim the exemption. Few supporting decisions for the above proposition are as under :

- *CIT vs. Smt. Beena K. Jain (1996) 217 ITR 363 (Bom.)*
- *Balraj vs. CIT (2002) 254 ITR 22 (Del.)*
- *CIT vs. Ajitsingh Khajanchi (2008) 297 ITR 95 (MP)*

Rollover of new flat which was booked under construction and new flat purchased because of genuine reasons

Consider a case where an assessee books a residential flat in an under construction project and makes investment in the same within the specified time but latter on cancels the booking and buys another residential flat. There might be many valid and genuine reasons for this. Some examples can be the project getting delayed abnormally, changes in the building plan subsequent to the booking which is not acceptable to the assessee, etc. There may be some more reasons attributable to the assessee himself like assessee or any of his family members getting transferred to a different city and hence he has to move the house to that city etc. What will be the situation of the assessee in such a case as far as the exemption u/s. 54 or section 54F is concerned. Some practical difficulties are likely to arise. It is possible that the flat which is finally purchased by the assessee would be purchased beyond the prescribed time limit.

In such a case, the investment made in the under construction project would not qualify for exemption since the same gets cancelled latter on and does not result in acquisition of the residential house as is required under the provisions of sections 54/54F. At the same

time the investment in the flat purchased after cancelling the booking will not qualify for exemption since it is made beyond the specified period of time. Accordingly technically speaking the assessee losses the benefit of exemption for both the houses and has to suffer the taxation. However the question here is whether such technical difficulties shall come in the way of a genuine assessee and he shall be made to suffer for no fault on his part.

I believe that in such situations the ultimate object of the section shall be kept in mind and the exemption shall be allowed to the assessee following liberal interpretation of the law. One needs to bear in mind that the exemption provisions shall be liberally construed and the benefit of substantial compliance shall certainly be given to the assessee. The exemption shall be allowed in respect of the booking money paid in the under-construction project since the assessee has shown his clear intention of making the specified investment. It should not matter much whether finally the residential house acquired in project "A" or project "B". As long as the assessee purchases a residential house, the exemption shall be allowed to him. The only question thereafter remains is about the time limit which might not be strictly followed in such a situation. For this, one must appreciate the fact that as long as the booking was made in the under-construction project, the assessee would not have presumed that it will be cancelled and he will have to look for another residential house. It could not have been anticipated by him that his investment in the under-construction project will turn bad and in such a scenario the benefit of exemption shall be allowed following a sympathetic approach. One should appreciate that the assessee has played his part of the action and what happened thereafter is only a misfortune. Accordingly, I believe that a reasonable judicial forum will always be in favour of granting exemption in such a situation.

At this juncture, it is also necessary to raise a word of caution against purposefully planning such things and thereby trying to buy more time for compliance of the conditions. If one plans on such things, it is very much likely that the series of events will reveal the correct facts and the judicial wisdom will prevail in such situation and the exemption will be denied if it is proved that the delay in investment was not for misfortune but for the planned affairs of the assessee.

Purchase of house outside India

The world is becoming smaller day-by-day and we have many global citizens now. Accordingly it is very common that an assessee may sell his residential house in India or other capital asset and make investment in a residential house outside India. A question arises as to whether in such a situation the exemption will be available under sections 54 or 54F for the investment made in the residential house outside India.

On bare reading of the provisions of both section 54 and 54F of the Act, it becomes clear that the sections require that the assessee should purchase a residential house. There is absolutely no reference in either of the sections that the new residential house shall be situated in India. As such, there shall not be any difficulty in claiming the exemption in respect of the investment in a house situated outside India. The object of sections 54 and 54F of the Act is to promote development of housing in the country. Accordingly, there can be a doubt as to whether the Indian Income-tax Act could have the object of developing the housing in foreign country and therefore one may tend to take a view that the object behind the sections is not achieved if the residential house is purchased outside India and hence no exemption shall be allowed.

However, one should keep in mind that as per the fundamental principle of interpretation of statute one cannot read any additional condition in any provision in any of the section. Under sections 54 or section 54F, there is no restriction about the new residential house being situated

in India and accordingly it cannot be read into when it is not specifically provided for. As a matter of judicial support one can rely on the decision in the case of *Mrs. Prema P. Shah vs. ITO (2006) 100 ITD 60 (Mum.).* In this case, the Mumbai bench of the Tribunal has clearly held that the exemption under section 54 of the Act cannot be denied to the assessee merely for the reason that the property acquired is in a foreign country if all other condtions of the section are satisfied.

Purchase of residential house in joint names with family members and purchase of house in the names of family members only

It is a common practice that the residential house is generally purchased in joint names with some of the family members. This is done as a matter of convenience and also as a prudent action. The issue which arises is whether in such a situation the exemption can be allowed to the assessee. The assessee is normally the first owner of the house and the second holder is some family members.

As explained earlier, what is required under sections 54 and section 54F is that the assessee shall purchase or construct the residential house to claim exemption. The section nowhere requires that the new house shall be owned by the assessee. Since the condition of ownership is not there, the exemption shall not be denied due to joint ownership without even going into question as to whether such joint ownership is only for the sake of convenience or it is a joint ownership as per the law.

The decisions of the Courts have been favouring the assessee in a case where the acquisition of the new house is in the joint names of the assessee and other family members or even outsiders as long as the funds for acquisition of the property have been spent by the assessee. In following decisions, it has been held that the exemption will be available in such a situation:

- *CIT vs. Ravinderkumar Arora (2012) 342 ITR 38 (Del.)*
- *DIT International Taxation vs. Mrs. Jennifer Bhide (2012) 349 ITR 80 (Kar.)*
- *Dr. P. K. Vasanthi Rangarajan vs. CIT (2012) 252 CTR (Mad.) 336*

This seems to be a settled position now as far as the joint ownership of the new property is concerned.

However, one more aspect of the matter can be that the investment in the new house is made entirely in the name of a family member of the assessee and the assessee is not included as the owner of the new house altogether. Since in such a case although the investment is made by the assessee, there is a doubt whether the new asset can be said to be purchased by the assessee since he is not the owner of the new asset. The judicial views in such a situation are completely divided.

In the case of *Late Mir Gulam Ali Khan vs. CIT (1987) 165 ITR 228 (AP)* where the assessee died after paying the earnest money and later on the legal heirs of the assessee completed the transaction of purchase in their name, it was held that the word "assessee" shall be given a wide and liberal interpretation and the exemption shall be allowed to the deceased assessee for the investment made in the names of the legal heirs.

In the case of *CIT vs. V. Natarajan (2007) 287 ITR 271(Mad.)* the assessee sold a house property and purchased another property in the name of his wife. The property so purchased in the name of the wife was assessable in the hands of the assessee. The Tribunal in the said case allowed the exemption to the assessee. The High Court held that the finding of the Tribunal was finding of fact and accordingly the claim of the assessee was not denied.

Recently in the case of *CIT vs. Kamal Wahal (2013) 351 ITR 4 (Del.),* the assessee has made investment in the name of his wife and has

claimed exemption u/s. 54F of the Act. The Delhi High Court held that that the exemption shall be allowed to the assessee since the payment is made by the assessee since the investment is not made in the name of any stranger but in the name of the wife of the assessee. The High Court has observed that there is nothing in section 54F to show that the house should be purchased in the name of the assessee only. It merely says that the assessee should have purchased/constructed "a residential house". The High Court has also observed that a purposive construction is to be preferred as against a literal construction.

As against the above favourable decisions, few other decisions have taken a totally divergent view in the matter and has held that in such a situation, the exemption will not be available to the assessee.

In the case of *Prakash vs. ITO (2009) 312 ITR 40 (Bom.)*, the assessee had purchased new property in the name of his adopted son and claimed exemption u/s. 54F of the Act. The Bombay High Court in this case held that the purchase in the name of the adopted son was with a clear intention to transfer the property to him and hence the assessee was not entitled to exemption in respect of the investment so made. The Bombay High Court also observed that purchasing the new property in the name of the adopted son effectively resulted in transfer of the property in the name of the son and accordingly the assessee violated the condition of section 54F that the new asset shall not be transferred within a period of 3 years.

In the case of *Vipin Malik (HUF) vs. CIT (2011) 330 ITR 309 (Del.)*, the High Court has denied the exemption to the assessee u/s. 54F of the Act. The claim of the assessee in this case was primarily denied due to the fact that the period of investment was not within the time prescribed in the section. Though this was the main reasoning for not allowing the claim, the High Court also observed that in any case, the claim was not allowable even otherwise since the agricultural land that was sold belonged to assessee HUF whereas the flat was purchased in the individual name of the Karta along with his mother. Thus, the new house was not purchased by the same assessee who sold the agricultural land and therefore exemption under section 54F was not allowable.

Further in similar situation the exemption u/s. 54B of the Act has been denied to the assessee in the case of *Jai Narayan vs. ITO (2008) 306 ITR 335 (P & H)* and also in the case of *Kalya vs. CIT (2012) 251 CTR (Raj.) 174.*

In view of the conflicting decisions of various High Courts on the subject, it seems that it will be very difficult to get the exemption where the investment is made in the names of the relatives only without the assessee's name included in the agreement. Though it is said that the exemption provisions shall be construed in a liberal manner, it seems that the liberal interpretation to such an extent may not be taken by the judicial forums. As observed by the Rajasthan High Court in the case of *Kalya vs. CIT (supra)*, the word "assessee" used in the Income-tax Act needs to be given a 'legal interpretation' and not a 'liberal interpretation'. If word 'assessee' is given a liberal interpretation, it would be tantamount to giving a free hand to the assessee and his legal heirs and it shall curtail the revenue of the Government, which the law does not permit.

Delay in investment due to late receipt of the consideration

Many a times the consideration is received late from the buyer of the old asset especially in cases of transfer of immovable properties where the consideration is received in installments. Similarly there might be cases where the person receives additional compensation due to litigation in case of compulsory acquisition of the properties. These types of situations may create genuine difficulty in as much as the time limit specified in the section is to be computed with reference to the date of transfer. If the

consideration is not received at the time of the transfer, a question does arise as to how the person would be making investment in the new asset in absence of the money available with him for making such investments.

If one goes by the language of section 54 or section 54F then in that case the benefit of the exemption will be available only if the investment is made within 2 years or 3 years as the case may be from the date of transfer of the property. Accordingly technically speaking the exemption will be denied to the assessee in such a case.

However one should bear in mind one of the fundamental principles of law that legislation cannot require a person to perform impossible things. If the assessee has not received the consideration, it would not be proper to insist that he would make investment in the new asset. Such impossibility of performance can never be insisted by the law to grant exemption. If such an interpretation is adopted, it would be absolutely unfair to the assessee and the exemption provisions will be redundant in such a situation. Though it is said that equity and taxation are often strangers, attempts should be made that these do not remain always so and if a construction results in equity rather than in injustice, then such construction would be preferred to the literal construction. Accordingly in such a situation, the investment made within the specified period after receipt of the consideration should enable the assessee to claim the exemption.

In this regard one can draw very good support from few of the decisions of the High Courts which are though given in context of some other section, the ratio of these decisions equally apply to provisions of sections 54 and 54F of the Act.

Hon'ble Andhra Pradesh High Court in the case of *S. Gopal Reddy vs. CIT (1990) 181 ITR 378 (AP)* was considering the claim of exemption u/s. 54E of the Act in somewhat similar situation of delayed receipt of compensation amount on acquisition of property. The Court observed that if the investment in specified asset was made within a period of six months from the date of receipt of compensation, as against the date of acquisition of the property denoting transfer thereof, the same should be considered to be sufficient compliance for the purpose of claiming exemption u/s. 54E of the Act.

Similarly situation was considered by the Allahabad High Court in context of section 54B of the Act in the case of *CIT vs. Late Janardhan Dass Through L/H Shyam Sunder (2008) 299 ITR 210 (All.).* In this case the enhanced compensation was received subsequent to the prescribed time limit of 2 years u/s. 54B. The court has held that the period of two years in such cases will commence from the date of enhancement of the compensation amount by the court. Somewhat similar is the ratio of the decision of the Andhra Pradesh High Court in context of section 54E of the Act in the case of *Darapaneni Chenna Krishnayya (HUF) vs. CIT (2007) 291 ITR 98 (AP).*

As a note of caution, the assessee should be better advised to make the investment at the earliest possible time once consideration is received and not to wait till end of two years from the date of receipt of consideration. Such prompt action of the assessee after receipt of the consideration would certainly earn due sympathy from the judicial forum and the assessee would be on a better footing.

Similar situation under section 54EC

While we are on sections 54 and 54F of the Act, it would be worth to also discuss similar situation which might arise in respect of section 54EC of the Act where the investment in the prescribed bonds is made beyond the period of six months from the date of transfer of the asset. Going by the above analogy and judicial decisions on the subject, the same ratio would apply in case of section 54EC and the claim would be allowable if the investment is

made within six months of the receipt of the consideration.

As far as section 54EC is concerned, there are in fact few direct decisions of the Tribunals in addition to the above decisions which can be useful to the assessee. The direct decisions in context of section 54EC are as under :

- *Chanchal Kumar Sircar vs. ITO (2012) 50 SOT 289 (Kol.)*
- *Mahesh Nemichandra Ganeshwade & Ors. vs, ITO (2012) 147 TTJ (Pune) 488*

In the case before the Pune Tribunal, the Tribunal has also referred to CBDT Circular No. 791 dated 2nd June 2000, which is given in context of impact of section 45(2) for investment in sections 54EA/54EB and 54EC of the Act. This also can be a useful tool to contend that the exemption shall be allowed if the investment is made within the prescribed time limit from the date of receipt of the consideration.

Due date for Investment in Capital Gains Account

Both sections 54 and 54F of the Act provide that in a case where the capital gain / consideration is not appropriated towards the purchase / construction of the new asset within one year before the transfer of the original asset or before the date of furnishing the return u/s. 139 of the Act, the assessee shall deposit the unutilised portion of the capital gain / consideration in an account with a bank under the capital gain account scheme before filing the return of income.

Issues arose as to whether the due date for making such investment in the capital gain account shall be the due date as prescribed u/s. 139(1) of the Act or it is permissible to make such investment within the time permitted for filing the Income-tax Return u/s. 139(4) of the Act. These issues arose for the reason that the section referred to unutilised amount up to the due date of furnishing the return under section 139 without specific reference to sub-section (1) of section 139. Accordingly the assessee contended that the exemption will be available even in cases where the investment in the capital gain account is made after the due date as prescribed u/s. 139(1) but within the time available u/s. 139(4) of the Act to file the Return of Income.

Courts and Tribunals have consistently held that the above contention of the assessee is correct and the exemption shall be allowed in such cases. Various decisions of the courts and Tribunals adopting the above view are as under:

- *CIT vs. Rajesh Kumar Jalan (2006) 286 ITR 274 (Gau.)*
- *Fathimabai vs. ITO (2009) 32 DTR (Kar.) 243*
- *CIT vs. Ms. Jagriti Agarwal (2011) 339 ITR 610 (P & H)*
- *CIT vs. Jagtar Singh Chawla (2013) 87 DTR (P &H) 217*
- *P.R. Kulkarni & Sons (HUF) vs. Addl CIT (2011) 135 TTJ (Bang) 630*
- *Kishor H. Galaiya vs. ITO (2012) 137 ITD 229 (Mumbai)*

Whether the exemption is available under both the sections in respect of the investment made in the same asset

An interesting issue comes up when an assessee sells a residential house property and makes investment in another residential house property. The investment in the new house is much more than the calculated amount of capital gains. The assessee also sells any other capital asset and the sale consideration of the same is also used for the purpose of acquisition of the new house property. The investment in the new house property is made on such dates as qualifies in the specified time limit under both the sections 54 and section 54F. The assessee claims exemption u/s. 54 in respect of the investment of capital gain arising out of

sale of old residence and also claims exemption u/s. 54F in respect of the net consideration arising from the transfer of the other capital asset. The investment is in the same house property for which the exemption is claimed under both the sections. The issue comes up whether in such a scenario, the exemption will be available under both the sections for the same property or the assessee will have to confine to exemption under one of the two possible sections.

If one goes by the object of the exemption provisions and also by the language of the provisions, there is nothing in either of the section which denies the applicability of the other section for the same property. In fact the proviso to sub-section (1) of section 54F provides that in a case where the assessee, purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset, the benefit of exemption under the said section will not be available. Accordingly the bar u/s. 54F is on acquisition of any residential house other than the new asset but not on making higher investment in the new asset itself.

Secondly both the sections are working in different areas and granting exemption for transfer of different assets. Accordingly one cannot say that the exemption will be available under any one of the sections. The sections are not substitute for each other but rather they are complementary to each other. Accordingly, there cannot be any doubt that the exemption will be available under both the sections for the investment in the same house subject to of course fulfilment of conditions under respective section.

The above view is also supported by the decision of the Mumbai Tribunal in the case of *Ravindra K. Mariwala vs. ITO (2003) 86 ITD 35 (Mum).*

Source or Investment – Is it necessary to invest from sale proceeds of old asset – Whether borrowed funds can be used for purchase of new asset

Another question which frequently arises is that what is the relevance of source of Investment in the new asset? Is it essential to invest the money in the new asset out of sale proceeds of the old asset?

If one goes by the scheme of these provisions, the answer becomes very evident that there is no such condition or restriction that the investment shall be made out of consideration of the old asset. Under both the sections exemption is allowable if the new asset is purchased within one year before or two years after the date of purchase of the old asset or the new residential house is constructed within three years after the date of transfer of the old asset. When the time limit for investment also includes the period of one year before the date of transfer of the old asset, it becomes clear that the scheme itself permits the exemption in a case where the investment is made from any source other than the sale consideration of the old asset. It is natural that the consideration for the old asset could not be received by the assessee prior to the date of transfer and the investment made during this period will certainly be out of funds from some other sources.

When the investment is permissible in the period of one year prior to the date of transfer of the old asset from any other source, the same logic shall continue even for the investment made post the transfer of the old asset. There is nothing in the section that denies the exemption if the source is other than the sale of the old asset. However, the revenue tried to deny exemption in many cases where the source of funds was not directly coming from the consideration of sale of old asset. The litigation on this issue reached to High Courts and Tribunals and the ratio of these decisions will be helpful in strengthening the case of the assessee to a considerable extent.

In the case of *ITO vs. K. C. Gopalan (2000) 162 CTR (Ker.) 566* where the sale consideration was placed in banks but the assessee has constructed a house within the prescribed time, the Kerala High Court has held that in order to get benefit of s. 54, there is no condition that assessee should utilise the sale consideration itself for the purpose of acquisition of new property. As regards section 54F, in *CIT vs. R. Srinivasan (2010) 45 DTR 208 (Mad.),* the assessing officer rejected the claim of exemption u/s. 54F on the ground that the investment in the new asset was not made from the sale consideration of the original asset. The Madras High Court held that the assessing officer is not justified in denying the exemption. Section 54F provides option to the assessee to invest even within a period of one year before the date on which the transfer takes place. There is no such pre-condition imposed by the provision to the effect that the property is to be purchased by the assessee out of consideration received on account of transfer of the capital asset. The section is clear, unambiguous and plain. The purpose of the section is to encourage investment in residential house and the same is required to be interpreted in such a manner as not to nullify the object.

A question also comes up as to whether the investment in the new asset out of borrowed funds will qualify for exemption under section 54 of 54F. Considering the fact that there is no stipulation as regards the source of funds for investment in the new asset, it is clear that even in such a situation the assessee would be entitled to claim exemption. As a legal support to this view, a useful reference can be made to the decision of *Bombay Housing Corporation vs. ACIT (2002) 81 ITD 545 (Mum.)* where the Tribunal has allowed the exemption u/s. 54E of the Act to the assessee for investment made in the specified assets out of borrowed funds observing that even if an assessee effects the borrowing not because of forced circumstances, but because he consciously or deliberately used the sale consideration for a different purpose, the exemption cannot be denied to the assessee. Fact that instead of making a direct investment in the bonds the borrowed amount was invested in the bonds should not make any difference in allowing the exemption.

Similarly in the case of *Mrs. Prema P. Shah vs. ITO (2006) 100 ITD 60 (Mumbai),* the assessee sold residential property in India and invested part of sale proceeds in shares and deposits and acquired a residential property in UK on lease by borrowing funds. The department argued that the same amount should have been utilised for the acquisition of new asset. The Tribunal held that such an argument is not sustainable and the exemption u/s. 54 cannot be denied to the assessee for the reason that the investment is made out of the borrowed funds.

We have dealt with some of the issues arising under both the section 54 and section 54F of the Act in the earlier part of the article. These are common issues which may be arising in both the sections. The judicial decision under section 54 can be equally applicable for section 54F and vice versa for the above issues since the scheme of the sections remain similar on the above issues. However though the provisions of both the sections are similar, there are some areas of differences in the two sections and accordingly some of the issues arise only under section 54. Similarly some of the issues arise only under section 54F due to its peculiar provisions. We shall now try to understand some of such typical issues arising in both these sections.

Typical issues that arise under section 54 of the Act

Original asset shall be a residential house

Exemption u/s. 54 of the Act is available in a situation where the assessee transfers a long term capital asset being buildings or land appurtenant thereto and being a residential house and purchases/constructs another residential house within the specified time. The

original asset shall necessarily be a residential house and no other asset. Issues arise as to what can be construed to be a residential house for the purpose of availing the exemption.

The word residential house is not defined in the Income-tax Act. Accordingly one should take the common meaning of the said term. A residential house shall mean a structure which is having the character of a house and is residential in nature. The house shall be a habitable house and it should be possible for a person to reside in the same. Though the level of comfort will be different in each case, the common ingredients of a house shall not be missing. Again it depends on the life style of a person. For a labourer, a kacha hut may be his house but the same will not be true for a person of eminence.

In the case of *Dr. A. S. Atwal vs. CIT (2005) 277 ITR 462 (P&H)*, the assessee was claiming exemption u/s. 54 of the Act in respect of transfer of plot of land with a tin shed on the same. The assessee claimed that the tin shed was the residential house. However, the Tribunal recorded a finding of fact that the structure which was claimed to be a residential house was only a tin shed surrounded not by any compound wall but only by barbed wire. There was neither any bathroom or kitchen nor any electricity provided in the said shed. Accordingly the Tribunal held that the structure cannot be considered as a residential house. This finding of the Tribunal was upheld by the Punjab & Haryana High Court and the assessee was not allowed the exemption u/s. 54 of the Act.

Land appurtenant to a residential house

The exemption is allowed on transfer of buildings or land appurtenant thereto and being a residential house. A question therefore arises as to what can be said to be a land appurtenant to a residential house. In common parlance, the land which is integral part of the residential house is considered to be land appurtenant to the building.

In *P. K. Lahiri vs. CIT (2005) 275 ITR 17 (All.)*, the assessee sold a part of land gifted to him by his father which was located in the same compound where his father's bungalow was situated. The land was in the name of the assessee whereas the bungalow stood in the name of his father. The assessee claimed exemption u/s. 54 on sale of the said land. The Allahabad High Court held that the land is "adjoining" the building and not "appurtenant" thereto. Therefore, benefit of section 54 is not available to the assessee on reinvestment of sale proceeds in new residential house.

The existence of the house as on the date of sale of the land appurtenant to the same is very essential. If the house is destroyed or demolished before the sale of the land appurtenant to the same, then it cannot be said that the land is appurtenant to the house and accordingly the exemption may be not allowed.

In the case of *Subhash Chand Kapoor vs. ITO (2010) 46 DTR (Agra)(Trib.) 314*, the assessee sold part of the land on 15th October, 2003 when the house was in existence. Latter on the assessee dismantled the residential house and sold the other part of the land on 26th December, 2003. The assessee claimed exemption u/s. 54 in respect of both the sales. On the basis of the evidences on record, the Tribunal held that the exemption will be allowable in respect of the sale of the land on 15th October, 2003 since at that time the house was in existence. However, before the sale of the land on 26th December, 2003 the house was dismantled and was therefore converted into land and hence the land sold on 26th December, 2003 cannot be said to be land appurtenant to the house and exemption cannot be allowed on such sale u/s. 54. The Tribunal however also held that this sale would qualify for exemption u/s. 54F of the Act.

Flat acquired in a scheme of redevelopment

Redevelopment of properties is the order of the day in city like Mumbai. Various tax issues keep

on emerging on account of properties in the hands of all the parties. Here we are concerned with an issue in the hands of the flat owner. When a flat owner surrenders his flat in a scheme of redevelopment and gets another flat against the same, whether he will be qualifying for exemption u/s. 54 of the Act in respect of the capital gains arising on transfer of the original flat.

The Income-tax department contends that in such a scheme, the assessee has neither purchased nor constructed the new flat and accordingly the exemption is not available. At the same time, the assessee feels that he has not sold his flat but merely agreed to redevelopment with a view to get better construction and modern amenities and accordingly no taxable event happens in his hands.

In such a case, one can again rely on the proposition that the purchase of the flat from a builder in an under construction project amounts to construction of the residential house. In a redevelopment agreement, the flat owner agrees to surrender his flat for a consideration that the developer will construct the new flat for him in the new building. Thus the agreement amounts to construction of the flat by the assessee through the developer and accordingly the same shall be qualifying for exemption u/s. 54 of the Act. Judicial support for this can be taken from the decision of the 'I' bench of Mumbai Tribunal in the case of ***Jatinder Kumar Madan vs. ITO (Order dated 25th April, 2012 in ITA No. 6921/Mum/2010); ((2012) 32 CCH 059 Mum. Trib.).***

Multiple sale and purchase of residential houses

Another peculiar aspect of the scheme of exemption u/s. 54 of the Act (as compared to section 54F) is that under section 54 of the Act an assessee will be eligible to claim exemption in respect of multiple sale and purchase of residential houses. As against this, the proviso to section 54F(1) provides that the exemption under the said section will not be available in a case where the assessee owns more than one residential house, other than the new asset on the date of transfer of the original asset.

Under section 54 of the Act there is no restriction as provided under the proviso to section 54F (1). If an assessee owns five houses and sells these five houses and against each such sale, the assessee purchases five new residential houses, he will be able to claim exemption in respect of each purchase of the residential house.

The Mumbai Tribunal in the case of ***Rajesh Keshav Pillai vs. ITO (2011) 44 SOT 617 (Mum.)***, has held that there is no restriction placed any where in the s. 54 that exemption is available only in relation to sale of one residential house. Therefore, in case the assessee has sold two residential houses, being long-term assets, the capital gain arising from the second residential house will also be entitled to exemption under s. 54. The Tribunal in this case has also held that in case there is sale of more than one residential house, the exemption will be available in relation to each set of sale and corresponding investment in the residential house.

However, the Tribunal held that the exemption has to be restricted to one residential house (contra to the decision of D. Anand Bassapa etc.) and the combination which is beneficial to the assessee has to be allowed. Accordingly the Tribunal rejected the plea of the assessee that exemption has to be calculated considering the aggregate of capital gain and aggregate of investment in the residential houses.

The decisions of Karnataka High Court in the case of D. Anand Bassapa, etc. have not been cited before the bench by either party. The Tribunal has followed the decision of the Special Bench in the case of Sushila M. Jhaveri without referring to the favourable decisions of the High Court. With due respect, it can be said that this decision of the Tribunal is erroneous

to that extent. Following the decisions of various High Courts in context of investment in multiple houses, a better view of the matter seems to be that exemption has to be calculated considering the aggregate of capital gain and aggregate of investment in the residential houses.

The decision in the case of Rajesh Keshav Pillai has also been followed by the Mumbai Tribunal in a latter decision in the case of *Dy. CIT vs. Ranjit Vithaldas (2012) 137 ITD 267 (Mumbai).*

Typical issues that arise under section 54F of the Act

As under section 54, some typical issues also arise under section 54F of the Act. This is due to those provisions of section 54F which are not there in section 54. The issues which so emerge are discussed hereunder :

Not owning more than one house on the date of transfer of the original asset

The proviso to section 54F(1) provides that the exemption under the said section will not be available in a case where the assessee owns more than one residential house, other than the new asset on the date of transfer of the original asset.

An issue arises as to what constitutes a residential house for the purpose of calculating the above limit of one house. Whether a joint ownership in a house is considered to be a house or only exclusive ownership will be considered as a house for this purpose. Take a case where Mr. X owns one house in his individual name. Mrs. X also owns one house in her name. Mr. X and Mrs. X jointly own one more house. In such a scenario, can it be said that both Mr. X and Mrs. X are owner of more than one house and accordingly they both will not be entitled to claim any exemption u/s. 54F if they sell any other capital asset or it can be said that since none of them is owner of more than one house in individual name, both will be eligible for claiming exemption u/s. 54F.

Here one should try to understand as to what is meant by owning a residential house. Owning a part of the house does not amount to owning a "house". The word house in the proviso shall mean a complete residential house and would not include shared interest in a residential house. Where the property is owned by more than one person, it cannot be said that any one of them is the owner of the property. In such a case, no individual person can on his own sell the entire property. One might at best be in a position of selling his share of interest in the property but as far as the property is considered, it would continue to be owned by co-owners. Joint ownership is different from absolute ownership. In the case of joint ownership of a residential unit, none of the co-owners can claim that he is the owner of residential house. Ownership of a residential house means ownership to the exclusion of all others. Therefore, where a house is jointly owned by two or more persons, none of them can be said to be the owner of that house.

For this proposition a very useful reference can be made to the judgment of the Supreme Court in the case of ***Seth Banarsi Dass Gupta vs. CIT (1987) 166 ITR 783 (SC).*** In this case the Supreme Court was considering the allowability of depreciation on an asset which was jointly held by the assessee. It was held that a fractional ownership was not sufficient for claiming even fractional depreciation under section 32 of the Act as it stood at the relevant point of time. Latter on section 32 of the Act was amended by using the expression "owned wholly or partly" to allow depreciation on joint owned assets. However, similar amendment is not carried out in section 54F of the Act and accordingly one can contend that the legislation has purposefully not made such amendment and it is intended that a joint ownership is not considered as a ownership of a residential house.

The above contention is directly covered by the decision of Madras High Court in the case of

Dr. P. K. Vasanthi Rangarajan vs. CIT (2012) 75 DTR (Mad.) 56 and also the Mumbai Tribunal in the case of *ITO vs. Rasiklal N. Satra (2006) 98 ITD 335 (Mumbai).*

Purchase of part of the house which is already partly owned by assessee

Another interesting issue emerges when the assessee owns say half share in one flat and the other half is owned by another person. The assessee transfers some capital asset and invests the sale proceeds in acquiring the other half interest in the same property from the joint owner. Whether in such a situation the exemption can be allowed to the assessee u/s. 54F of the Act. To put differently can purchase of a part of the house (which is already owned partly by the assessee) will qualify for exemption or not.

In this connection, one should note the fine distinction between the words of sub-section (1) of section 54F and the proviso to the said sub-section. Whereas sub-section (1) requires an assessee to "purchase" a residential house, the proviso denies exemption when the assessee "owns" more than one residential house as on the date of transfer. There is material difference between the word purchase and the word own. Whereas purchase means purchasing for a price the word owns means owning to the exclusion of the entire world. As such, the discussion of joint ownership made while dealing with the earlier issue shall not be acting as a deterrent when one is examining the condition of purchase of the new asset. Accordingly the purchase of part of the house shall qualify for exemption u/s. 54F of the Act.

For the proposition that purchase of a part of the house amounts to purchase of a house one can draw a strong support from the decision of the Supreme Court in the case of *CIT vs. T. N. Arvinda Reddy (1979) 120 ITR 46 (SC).* In this case, it has been held that purchase primarily means acquisition for money paid. The Supreme Court in this case has allowed exemption u/s. 54 in respect of purchase of share of interest in the joint house by one brother from other brothers.

The above issue is also directly covered in favour of the assessee by the following Tribunal decisions :

- *Smt. Kalawanti D. Alreja vs. ITO (1996) 54 TTJ (Bom.) 593*
- *Balwantram U. Chimna vs. ITO (2001) 72 TTJ (Ahd.) 451*
- *ITO vs. Smt. Varsha P. Thanawala (ITA No. 625/Mum./2002)(Mum.)*

Exemption u/s. 54F or section 54EC vis-à-vis Capital Gains u/s. 50

An issue also arises as to whether the assessee will be able to claim exemption u/s. 54F/54EC against capital gains arising on transfer of an asset which is as such a long-term capital asset but the assessee has been allowed depreciation on the said asset and therefore the capital gain is considered to be a short-term capital gains u/s. 50 of the Act.

In this connection, it is very relevant to refer to the language of section 50 of the Act. Section 50 provides that where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under the Act, the provisions of sections 48 and 49 shall be subjected to some modification as specified in the section. As against this, section 54F provides that the exemption is allowable to an assessee where the assessee transfers a long-term capital asset and makes investment in a flat within the specified time. Similar exemption is granted by section 54EC for investment in specified bonds within the period of six months.

On a conjoint reading of all these provisions of the Act, it becomes clear that section 50 has got overriding effect over the provisions of section 48 and section 49 of the Act. But these provisions do not override section 54F or section 54EC of the Act. A deeming fiction

is created under section 50 of the Act which has the effect of modifying the provisions of section 48 and section 49 of the Act to the extent specified in section 50. But the role of this deeming fiction ends with this and the same cannot be extended to other provisions of the Act like section 54F or section 54EC. Accordingly it can be said that in such a situation, though the capital gains will be assessed as short-term capital asset due to section 50, the exemption u/s. 54F or 54EC will be available due to the fact that the relevant asset is a long-term capital asset.

The above issue is also directly covered in favour of the assessee by the decision of the Bombay High Court in the case of *CIT vs. Ace Builders Pvt. Ltd. (2006) 281 ITR 210 (Bom.),* where exemption u/s. 54E of the Act has been allowed against of short-term capital gains computed u/s. 50 of the Act.

Conversion of capital asset into stock-in-trade – Time limit for Investment for claiming exemption

Section 2(47) of the Act provides that any conversion of capital assets into stock-in-trade shall be regarded as a transfer. This transfer arises in the year in which such conversion takes place and, accordingly, capital gain would normally arise in that very year. However, s. 45(2) of the Act postpones the assessment of such capital gains to the year in which the stock-in-trade is actually sold or otherwise transferred by the assessee.

An issue arises where an assessee converts his capital asset into stock-in-trade in say year 1 and ultimately sells the said stock-in-trade (earlier capital asset) latter on say in year 3. As per the provisions of section 45(2) the capital gain will be assessed in the latter year when the asset is ultimately sold. Issue arises as to what will be the time limit available to the assessee to make investment in a residential house and claim exemption u/s. 54F of the Act. Whether such time limit shall be taken from the date of conversion of the asset to stock-in-trade since that is the date of transfer of the capital asset technically speaking. Or should the time limit shall be considered from the date of ultimate sale of the stock-in-trade.

In such a case, if one goes by the language of section 45(2), it categorically provides that the capital gains shall be chargeable to tax in the year in which the said stock-in-trade is sold or otherwise transferred. Accordingly it seems that the correct position shall be that the date of transfer shall be the relevant date and not the date of conversion of the asset in stock-in-trade. If one adopts a view that the date of conversion of the asset in stock in trade is relevant for determining the time available for investment, one is putting an impossible burden on the assessee. On the date of mere conversion of the capital asset into stock-in-trade, the assessee does not receive any money and so it is not possible for him to make an investment as required u/s. 54F of the Act. The rule of harmonious interpretation shall also lead to a conclusion that the date of asset shall be reckoned with reference to the year in which the capital gain is taxable following section 45(2).

For this purpose, useful reference can also be made to two circulars of CBDT which have been issued in context of section 54E/54EA /54EB/54EC of the Act. *Vide* Circular No. 560 dated 18th May, 1990, CBDT expressed a view that for the purpose of section 54E of the Act investment shall be made within the time prescribed from the date of conversion of the asset. However, latter on the CBDT realised the practical difficulty faced by the tax payers and therefore another circular being Circular No. 791 dated 2nd June, 2000 was issued. *Vide* this latter circular it was recognised that it is not possible for an assessee to make the required investment under the aforesaid sections at the point of conversion of capital asset into stock-in-trade because the right to collect sales consideration in such cases arises only at the point of sale or transfer otherwise of stock-in-trade. Accordingly it was clarified that the

period of 6 months for making investments in specified assets for the purpose of sections 54EA, 54EB and 54EC should be taken from the date such stock-in-trade is sold or otherwise transferred in terms of section 45(2) of the Act.

Though the above circulars are issued in context of section 54E/54EA/54EB/54EC of the Act, the same principle applies to the scheme of section 54F of the Act and accordingly the same shall be applicable to section 54F in the similar manner. Even otherwise, if literal interpretation of a section results in absurdities, then such interpretation shall be avoided. Where more than one interpretation of a section is possible, the interpretation which advances the object of the section shall be preferred as against the interpretation that frustrates such object.

Issues arising out of section 54EC of the Income-tax Act

Section 54EC of the Act provides for exemption from long-term capital gains in a case where the assessee makes investment in specified bonds (NHAI and REC bonds) within a period of six months after the date of transfer of the original asset. Various issues keep on arising from time to time under this section as well. We shall now deal with some of such vital issues that arise in a routine manner:

Limit of ` 50 lakhs applies *qua* financial year or *qua* the capital gain

Proviso to sub-section (1) of section 54EC provides that on or after 1st April, 2007, the investment made in the specified bonds during any financial year shall not exceed fifty lakh rupees.

An interesting issue comes up in a case where the assessee transfers his capital asset in the latter half of a financial year and makes investment of ` 50 lakhs in the same financial year and further ` 50 lakhs in the next financial year so however that both the investments are made within the period of six months from the date of transfer of the original asset. Say for example – The asset is transferred on 15-1-2013. The assessee makes first trench of investment for ` 50 lakhs in the specified bonds on 25-3-2013. The assessee again makes further investment of ` 50 lakhs in the bonds on 15-5-2013 and claims exemption u/s. 54EC of the Act for aggregate investment of ` 1 crore. Whether in such a situation, the exemption will be available for ` 1 crore or for ` 50 lakhs ?

When one goes by the section 54EC of the Act and the proviso to sub-section (1) of the said section, it becomes clear that the restriction put by the proviso is not on the amount of exemption which can be availed by the assessee under this section but the ceiling is on the amount of investment which can be made in a financial year. Accordingly if the assessee makes investment in two different financial years and both the dates are within the period of six months of date of transfer, certainly the assessee shall be able to claim exemption in respect of both the investments made by him.

Though the above issue looks very simple on the plain reading and literal interpretation of the section, unfortunately the views of various benches of the Tribunal on this issue are divided as of now. In the following cases, the issue is decided in favour of the assessee:

- *Aspi Ginwala & Others vs. Asst. CIT & Others (2012) 52 SOT 16 (Ahd.)*
- *ITO vs. Ms. Rania Faleiro (2013) 142 ITD 21 (Panaji)*

As against these favourable decisions, the Jaipur Tribunal in the case of Asst. *CIT vs. Raj Kumar Jain & Sons (HUF) (2012) 50 SOT 213 (Jaipur)* has adopted a view that in such situation the exemption will be available for only ` 50 lakhs and not more.

It seems that the better view is that both the investments shall certainly qualify for exemption u/s. 54EC of the Act. This is on the basis of plain reading of the section and literal interpretation. Secondly even if one feels that a different interpretation is possible in the above

matter, the view in favour of assessee should be followed considering the fact that section 54EC is an exemption provision.

It is to be noted that in the case before the Jaipur bench of the ITAT, the Tribunal has gone by a logic that if exemption is permitted for both the investments, the assessee who transfers his asset in the first half of the financial year will be getting exemption of maximum ` 50 lakhs whereas the assessee who transfer the capital asset in the latter half of the financial year will be in a position to get exemption up to ` 1 crore and accordingly there will be discrimination between two classes of assessees. With due respect to the Hon'ble Tribunal, it seems that such situation could not have been out of the mindset of the legislature when the proviso was inserted in section 54EC. When the legislation in its wisdom has used the words "in a financial year" in the proviso, it should be given its literal meaning. One cannot presume that these words have crept in the section accidentally without the appropriate intention.

Limit of ` 50 lakhs – Whether separate limit is available in cases of clubbing of income

Another issue that arises out of the proviso to sub-section (1) of section 54EC is that in a case where there is a clubbing of income of one assessee in the hands of another assessee, whether the limit of ` 50 lakhs is available to both the assessees separately or the total amount of exemption will be restricted to ` 50 lakhs.

For example let us consider a case where a minor's income is clubbed in the hands of his father as per section 64(1A) of the Act. The minor has earned long-term capital gains during the year and makes investment of ` 50 lakhs in the specified bonds to avail exemption u/s. 54EC. Similarly there is a long-term capital gain in the individual name of the father and he also invests ` 50 lakhs in the specified bonds and claims exemption u/s. 54EC. In such a situation, whether the exemption will be available for both the investments or it will be restricted to ` 50 lakhs ?

To understand the correct position of law, one should refer to the provisions of the relevant clubbing section. In our example, the applicable section is section 64(1A) of the Act. Section 64(1A) provides that in computing the total income of any individual, there shall be included all such income as arises or accrues to his minor child subject to certain exceptions. Here the important phrases are "such income" and "total income". The phrase "such income" should be read with reference to "total income". Accordingly it becomes clear that what is to be clubbed in the hands of the parent is the "total income" of the minor.

The term "total income" is defined under the Act. Section 2(45) of the Act defines the term "total income" as the total amount of income referred to in section 5, computed in the manner laid down in this Act. As such, one should understand that the total income is to be computed in the manner laid down in the Act and section 54EC is a part of the Act. Therefore, what is to be clubbed in the hands of the parent is the Taxable Income after considering all the provisions including exemption provisions under section 54EC of the Act.

In view of the above, the clubbing will be made of only the Net Income after exemption and the exemption of ` 50 lakhs each will be available to both the minor and also the parents. The income of the minor that remains after claiming exemption u/s. 54EC will be only clubbed in the hands of the parent applying the provisions of section 64(1A) of the Act. This issue is squarely covered in favour of the assessee by the decision of the Kolkata Bench of the ITAT in the case of *Dy. CIT vs. Rajeev Goyal (2012) 52 SOT 335 (Kolkata).*

Considering the earlier issue (limit per financial year) and also the current discussion in a case where a property jointly owned by a parent and minor child is transferred in the latter half

of the financial year, the assessee can plan his affairs in such a manner so as to get exemption of total ` 2 crores under section 54EC of the Act. Such arrangement will be within the frame work of law and will certainly be permissible considering various judicial decisions on the subject.

Deemed extension of time when the specified bonds are not available

Section 54EC provides that the exemption will be available to the assessee on making investment in the specified bonds within six months of the date of transfer of the original capital asset. As of now, the bonds issued by NHAI and REC are notified for the above purpose. These bonds are issued by NHAI / REC from time to time. Further, the bonds are issued to the extent of the funds needed by these companies and the approval received from the Government for the same.

At times it so happens that the assessee wishes to avail the exemption u/s. 54EC but unfortunately the subscription to the specified bonds is not open during the relevant period and therefore the assessee cannot make the investment within the period of six months from the date of transfer. However, the bonds are available latter on (say after about seven months or eight months) and the assessee makes investment immediately once the subscription to the bonds are open. In such a situation, though the assessee has made the investment in the bonds as per the requirement of the section, the investment is beyond the specified period of six months and therefore the Income-tax Department many a times denies the exemption to the assessee.

However in this context it is necessary to note that the delay in the investment is due to the fact that the specified bonds were not available during the relevant period of time. This delay is not attributable to the assessee and therefore it would be inappropriate to make the assessee suffer for some technical fault which was not in his control. The exemption shall be allowed to the assessee in such a situation on the basis of substantial compliance and considering the object of the section. The principle that law cannot require a person to perform an impossible task is also a relevant principle which needs to be considered in such a situation.

Fortunately there are few decisions available on the subject favouring the assessee in such a situation. The decisions have also held that the choice out of the specified bonds is with the assessee and if the bonds of the assessee's choice are not available at the relevant time then the investment made in such preferred bonds once the same are available should entitle the assessee to claim exemption. A very useful reference in this regard can be made to the decision of the Bombay High Court in the case of *CIT vs. Cello Plast (2012) 76 DTR (Bom.) 439.*

Implication under MAT

Though section 54EC grants exemption in respect of the long-term capital gains earned by an assessee, one should bear in mind that such exemption will not be available under MAT if the provisions of section 115JB are applicable to the corporate entities. The corporate assessee would be getting exemption u/s. 54EC but the same income would be subjected to MAT in a given situation and accordingly the scope of the benefit reduces considerably. This aspect of the matter needs to be bear in mind while deciding about the investment to be made in the bonds for claiming the exemption under this section.

In the case of a foreign company which does not have any presence in India, the provisions of section 115JB will not be applicable since it is not required to prepare its accounts in accordance with Schedule VI of the Companies Act. As such in the case of such foreign companies, the benefit of exemption u/s. 54EC would be available without any implication of MAT if all the conditions of the section are otherwise fulfilled.

Whether the exemption u/s. 54EC will be computed prior to set off of brought forward long-term capital loss or post allowing set off such long-term capital loss

Consider a case where the assessee has earned long-term capital gains of say ` 2 crores in A.Y. 2013-14. The assessee has got unabsorbed long-term capital loss of ` 1.75 crores from the earlier years. The assessee makes investment of ` 50 lakhs in the specified bonds and wishes to claim exemption u/s. 54EC for this amount. In such a situation, whether (a) the exemption of ` 50 lakhs should be allowed first and then the brought forward loss shall be adjusted against the Net Capital Gain of ` 1.50 crores or (b) the brought forward long term capital loss of ` 1.75 Crores shall be adjusted first and the exemption shall be allowed for the balance ` 25 lakhs. If the first option is followed then the assessee will be eligible to carry forward the sum of ` 25 lakhs to subsequent years as unabsorbed capital loss. In latter option the brought forward unabsorbed loss of ` 1.75 crores will extinguish and the assessee's investment to the extent of ` 25 Lakhs will be fruitless.

A plain reading of s. 54EC indicates that it sets out a situation in which the capital gain is not to be taxed. The said section provides that where the capital gain arises from the transfer of a long-term capital asset and the assessee invests, within the permissible time-limit wholly or partly in such long-term capital gains, such capital gains will not be charged to tax under s. 45 in entirety, where the investment is not less than the capital gains in question, or on *pro rata* basis, where the investment is less than the capital gains in question. It is thus clearly an exemption provision in nature inasmuch as it specifies the situation in which capital gains, otherwise taxable, will not be taxed. In effect when and to the extent s. 54EC comes into play, the related capital gains cannot be part of chargeable income under the head "Income from capital gains".

Section 74 which deals with carry forward and set off of loss under the head "Capital gains", provides that when a long-term capital loss is carried forward, it shall be set off against long-term capital gains assessable for that assessment year. Thus, when a long-term capital loss is carried forward, it can be set off only against such income as or assessable under the head Capital gains in a subsequent year.

A conjoint reading of both the provisions would show that while section 54EC comes into play in the process of computing capital gains which are assessable under the head "Capital gains" section 74(1)(b) comes into play only when the income assessable to tax under the head Capital gains is computed. The stage at which set off of carried forward long-term capital loss is to be given is subsequent to the stage at which income under the head Capital gains is computed and deduction under section 54EC is to be given in the course of the latter. In this view of the matter, the question of setting off brought forward long-term capital loss arises only after the income under the head Capital gains is computed and that the processing in computing the income under the head Capital gains must also taken into account section 54EC as well.

For this proposition a useful support can be drawn from the decision of the Madras High Court in the case of *CIT vs. Vijay M. Mahataney (2013) 92 DTR (Mad.) 180* and also that of the ITAT in the case of *Tata Power Co. Ltd. vs. Addl. CIT (2011) 47 SOT 470 (Mumbai).*

Whether exemption is available for investment made in joint names of the assessee and family members

The issue as to whether the investment in the specified bonds made in the joint names of the assessee along with the family members of the assessee arises in similar manner as it arises in section 54 and section 54F of the Act. However this issue seems to be settled in favour of the

assessee by various decisions. The following decisions are relevant in this context :

- *DIT International Taxation vs. Mrs. Jennifer Bhide (2012) 349 ITR 80 (Kar.)*
- *Asst. CIT vs. Vijay S. Shirodkar (2011) 48 SOT 8 (Mumbai)*

What is the date of investment

The section requires an assessee to make investment within the period from six months from the date of transfer of the original capital asset. Here also some issues arise as to what is considered to be the date of investment. In the case of *Hindustan Unilever Ltd. vs. Dy. CIT (2010) 325 ITR 102 (Bom.),* the High Court was posed with a situation where the reassessment was sought to be made by the revenue and one of the reasons was that the exemption u/s. 54EC was wrongly allowed. The investment in the bonds was required to be made by the assessee by 28th March, 2004. The investment was made by the assessee on 19th March, 2004 but the bond was issued on 9th June, 2004. On these facts the Bombay High Court held that the investment is made within the prescribed time limit and accordingly the provisions of section 54EC are duly complied. Accordingly it should be understood that the date of investment is the date of payment made by the assessee and even if the bonds are issued after the period of six months by the concerned authority, the exemption should not be denied to the assessee.

Period of six months shall be considered from the end of the month in which the original asset is transferred

In the case of *Yahya E. Dhariwala vs. Dy. CIT (2012) 49 SOT 458 (Mumbai),* the Tribunal has observed that six months period should be reckoned from the end of the month in which the transfer takes place. These observations of the Tribunal may be helpful to the assessee in those cases where there is delay of few days in making the investment but the same is made within six months from the end of the month of transfer.

Conclusion

The subject of exemptions from capital gains is very vast and complex subject. In this article an attempt has been made to deal with some of the issues arising from sections 54, 54F and section 54EC. Though an attempt has been made to cover all the recent controversies on the subject and also to deal with various views on the respective issue, it is quite possible that some of the issues or aspects of any particular issue might have been missed out inadvertently. For better understanding of any particular issue, the readers are advised to refer to the provisions of the Act and also the available decisions on the issue in a threadbare manner. The readers are also advised to avoid planning any tax affairs on the basis of the views expressed in this article since each case will ultimately be decided on its own facts.

In the end, I would like to express my sincere thanks to the Chamber of Tax Consultants for giving me this wonderful assignment to write on this ever interesting subject. This assignment gave me one more opportunity to go through the entire subject once again and relearn many aspects on this subject. I must admit that in the process I was the biggest beneficiary since I learnt many new things and many of my own doubts were cleared to a great extent.

"Happiness is part of who we are. Joy is the feeling"

— *Tony DeLiso*

CA Rutvik Sanghvi

Taxation of Capital Gains earned by Non-residents

Since the opening up of the economy almost two decades back, many non-residents have found favour with investments in India. This article aims at discussing the various provisions and issues related to taxation of capital gains earned by non-residents in India.

The broad outline of this article is as follows:

1. Taxability in India of capital gains earned by Non-residents.
2. Computation of taxable capital gains.
3. Applicable Tax Rates for capital gains under the Act.
4. Taxability of capital gains under the DTAAs.
5. Special provisions for gains earned by Non-resident Indians.
6. Taxability of gains earned by FIIs.
7. Taxability of gains on transfer of bonds and GDRs.
8. Taxability of gains earned by QFIs.
9. Taxability of gains earned by FVCIs.
10. Taxability of gains earned by Offshore Funds.
11. "Indirect transfers" – taxability and issues.
12. Deductibility of tax at source from capital gains.

1. Taxability in India of capital gains earned by Non-residents

1.1 Scope

Section 5 of the Income-tax Act ("the Act") provides for the scope of income taxable in India for non-residents. Section 5(2) of the Act provides that income which is received; accrues or arises; or is deemed to accrue or arise to a non-resident in India is taxable under the Act.

1.2 Charge of tax

Section 45 of the Act provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to tax under the head "Capital gains" and shall be deemed to be income of the previous year in which the transfer took place.

1.3 Source of income

A cumulative reading of the above provisions results in capital gains arising in the hands of a non-resident in India if the **transfer** of the capital assets happens **in India**.

1.4 Deeming Provision

Section 9 of the Act further extends this scope by deeming certain incomes to arise in India. Capital gains that would be deemed to arise in India under Section 9 would be all income arising, whether directly or indirectly, through

the **transfer of a capital asset situate in India.** It envisages taxability in a case where income may arise outside India due to transfer happening outside India, but is still deemed to arise in India if the capital asset transferred is situated in India.[1]

For example, take a case where an Indian house property is transferred by one non-resident to another non-resident outside India, i.e., the contract for sale is executed outside India and full price is paid outside India. As per Section 5, tax on gain would not be chargeable to tax in India as transfer happens outside India. However, as per Section 9 as the property is situated in India, the gain is deemed to arise in India.

1.5 Indirect transfers

Till the enactment of Finance Act 2012, Sections 5 & 9 did not bring to tax gains earned by a non-resident on transfer outside India of an asset situated outside India. In the recent decision of Vodafone International B.V.[2] the Hon'ble Supreme Court has dealt with an important jurisdictional issue where:

– the transfer happens outside India,

– of an asset situated outside India, but

– which derives its substantial value

– from capital assets situated within India.

This decision held that income earned on such a transfer does not lead to taxation within India. This has resulted in amendments to Section 9 – not only to counter the Supreme Court's decision but also the various factors cited by the Hon'ble Judges which led to such a decision. These amendments were made retrospectively with effect from 1st April 1962. This has in turn brought about controversial issues regarding taxability in India of overseas transfers. Now an indirect transfer is taxable in India if it satisfies the conditions laid down in section 9. A detailed discussion on 'indirect transfers' is made in Para 11.

1.6 Taxability under the Double Tax Avoidance Agreements

India has entered into Double Tax Avoidance Agreements (DTAA) with several countries. As per Section 90(2), taxability for non-residents is determined as per the provisions of the Act or the applicable DTAA, whichever are more beneficial. Capital gains under the DTAA are generally taxed in a different manner than other incomes. The provisions are discussed in Para 4.

1.7 Exemption from tax

A substantial benefit available to both residents and non-residents is exemption from income-tax under Section 10(38). Long-term capital gains earned on transfer of equity shares or units of an equity-oriented fund on which securities transaction tax (STT) is paid at the time of sale, are exempt. This provides a major relaxation in the taxation of capital gains in the hands of non-residents. Quite a few older provisions providing reduced rates of tax for long-term capital gains have been rendered largely ineffective due to this exemption.

2. Computation of taxable capital gains

Once the gains are determined to be taxable in India, as per the Act or the DTAA, computation of such gains would be determined as per the provisions of the Act. Computation mechanism for capital gains is not provided under the DTAAs. Section 48 provides the mechanism to compute capital gains earned in India.

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1 Kanga & Palkhivala's The Law and Practice of Income-tax, Seventh Edition, Page 205.

2 Vodafone International Holdings BV vs. Union of India [2012] 341 ITR 1 (SC)

2.1 Base provision

As per Section 48, the full value of consideration received on transfer is to be reduced by the expenditure on transfer and the cost of acquisition or improvement. However, this computation is to subject to certain adjustments as required by the provisos to Section 48.

2.2 Foreign Exchange Fluctuation Adjustment:

The first proviso to Section 48 provides for adjustment of foreign exchange fluctuations in the value of rupee. This provision is applicable to:

- capital gains – short-term or long-term;
- arising on transfer by a non-resident;
- of shares or debentures of an Indian company;
- purchased out of foreign currency.

In such a case, capital gains shall be computed by converting the amount of sale consideration into the same foreign currency as was used at the time of purchase. Thus the proviso, in essence, prescribes computation of capital gain in foreign currency. Such conversion neutralises the impact of any fluctuation in the value of rupee.

For example, an investor has invested USD (US Dollars) 1,000 at a rate of ` 45 per USD in 2011, i.e., ` 45,000. If the value of his investment appreciates to ` 60,000 by 2013, he would earn ` 15,000 in Rupee terms on sale of the securities. However, in USD terms, he would not have earned any gain.

Sr. No.	*Particulars*	*In Rupees*	*In USD*
a.	Cost (at ` 45 per USD)	45,000	1,000
b.	Sale consideration (at ` 60 per USD)	60,000	1,000
c.	Gain in respective currency (b – a)	15,000	Nil
d.	Taxable gain on account of application of first proviso to Section 48	Nil	

As per this provision, taxable gains would be computed in the same currency as was utilised at the time of purchase. Hence, the non-resident's capital gains would be converted into USD. This would result in nil taxable gain for the non-resident.

There are certain issues to the above computation which are mentioned below:

2.2.1 Does the tax payer have an option to choose applicability of this provision?

The objective to introduce this provision was to provide protection to non-residents from devaluation of the rupee. However, it applies also when the rupee appreciates in value.

In such a case, the taxable gain would increase. Modifying our earlier example, if on the date of sale, the Rupee is valued at ` 30 per USD, the non-resident stands to earn taxable gain in the following manner:

Sr. No.	*Particulars*	*In Rupees*	*In USD*
a.	Cost (at ` 45 per USD)	45,000	1,000
b.	Sale consideration (at ` 30 per USD)	60,000	2,000
c.	Gain in respective foreign currency (b – a)	15,000	1,000
d.	Gain on account of application of first proviso to Section 48 (USD 1,000 at ` 30)	30,000	
e.	Additional Gain taxable on account of appreciation in value of Rupee (d - c)	15,000	

Therefore, on application of the first proviso to Section 48, the non-resident stands to pay tax on foreign exchange gain earned on appreciation in value of Rupee.

One view is that this provision is a relief giving provision. Hence if there is an increase in the taxable gains, the provision does not apply.

The Central Board of Direct Taxes (CBDT) has issued a circular at the time of enactment of this provision[3]. It states that – *"The non-resident Indians who invest in shares and debentures of Indian companies have been representing that due to the fall in the value of the Indian rupee vis-a-vis the foreign currency in which the investment is made by them, they are adversely affected when they sell such shares or debentures. In order to overcome this situation, sub-section (1) of section 48 of the Income-tax Act has been amended …".* The intention may have been to give relief only in case of fall in the rupee value. On rupee appreciation, no adjustment may be required.

While the provision would have been brought into law with the above intention, the language does not support any option for the tax payer. It merely states that capital gain is to be calculated in foreign currency. It does not mention that the conversion is to be done only in case of devaluation of rupee.

This may also be right as practically any non-resident would calculate the gains in his home country's currency, and not in Indian rupees. The provision in that manner neither benefits him, nor puts him at any disadvantageous position when computed in foreign currency. In my view, this is a mandatory provision.

2.2.2 Is this benefit available to shares or debentures gifted or inherited?

Assume a case where shares or debentures purchased out of foreign currency are acquired by the non-resident seller on account of gift or inheritance. In such a case, the seller has not himself purchased the assets out of his own foreign currency. Can the benefit be denied in such a case?

The proviso does not lay down any condition for purchase of the shares or debentures, except for the fact that it should be out of utilisation of foreign currency. If the shares or debentures are purchased out of foreign currency by the original owner, in my view, capital gains earned by a non-resident would be covered within the provision for foreign exchange fluctuation adjustment.

2.2.3 Whether adjustment is from date of investment or date of remittance?

In a case where the foreign exchange funds are remitted to India, but are used for purchase of shares or debentures much later, there is a chance that the value of rupee has depreciated even before purchase.

For example, the non-resident investor has remitted USD 1,000 into India and the foreign exchange rates applicable are:

Date	Foreign Exchange Rate	Amount in Rupees
On date of remittance – 1st April 2011	` 45 per USD	45,000
On date of purchase of shares – 31st December 2011	` 50 per USD	50,000
On date of sale – 1st February 2013	` 60 per USD	60,000

Whether the non-resident seller can claim adjustment for the devaluation of ` 5,000 incurred between the date of remittance and date of purchase?

The provision states that conversion has to be done for the cost of acquisition. As per the Rules[4], the prescribed date for conversion of cost is the date of purchase. Therefore, protection against devaluation between date of remittance and date of purchase may not be available to the non-resident.

2.2.4 Difficulties in respect of reinvestment of sale proceeds

The provision states that *"the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter …"*

3 Circular No. 554 dated 13th February 1990 183 ITR St 138.

4 As per Rule 115A

How does one apply this condition? What is the meaning of reinvestment thereafter? What should be the rate of foreign exchange for converting the cost of shares? Should we take the rate as on the date of re-investment, or should we take the original rate when funds were first invested?

For example, the non-resident investor has reinvested the sale proceeds of ` 60,000 from the example above in 2013. The cost of such shares was ` 45,000 when purchased in 2011.

In the above example, the amount of reinvestment is ` 60,000. However, the amount which had been invested out of foreign currency is only ` 45,000. Does the computation as per this provision apply to reinvestment of the original amount of `. 45,000, or the sale proceeds of ` 60,000? The excess over ` 45,000 (i.e., 15,000) comprises of rupee funds earned in India. There is no foreign currency utilisation at all.

In my view, one may take a logical view. The objective is that for non-residents, the gain should be computed in foreign currency. In case the initial remittance was from foreign currency, adjustment can be done for the subsequent reinvestment out of the initial investment. Therefore one should convert the whole amount of reinvestment for such adjustment; and the rate to be applied should be the rate of foreign currency as on the date of reinvestment.

2.3 Adjustment for inflation

The second proviso to Section 48 provides protection from inflation in India. This enables the assessee to compute gains after increasing the costs by prescribed indexation factors. The loss on account of inflation is offset to a limited extent in this manner.

Provisions of 'indexation benefit' and 'foreign exchange fluctuation adjustment' are mutually exclusive. Therefore, indexation benefit applies to non-residents only for capital assets other than those for which foreign exchange fluctuation adjustment applies (for example, for house properties, etc.). CBDT[5] has been clear in its view that as protection is already provided for forex fluctuation under the first proviso to Section 48, which takes into account inflation, further relief under the second proviso will not be available.

Indexation benefit is available for both residents and non-residents. However, unlike the first proviso, the benefit is restricted only to long-term capital gains, and not short-term capital gains.

3. Applicable tax rates for capital gains under the Act

3.1 Tax liability in the hands of non-residents on capital gains is determined by Section 111A, Section 112 and the 'rates in force' as prescribed under the Finance Act. Surcharge and education cess, as applicable, are added to these rates.

3.2 Short-term capital gains

Short-term gains are taxable in like manner for residents and non-residents. The below table summarises the rates of tax applicable for short-term gains:

Type of asset	Rate of tax	Legal provisions
Equity Shares or units of an equity-oriented fund, on which STT is paid	15%	Section 111A
Capital assets other than those mentioned above including off-market sale of listed equity shares and units of equity-oriented fund	a. Slab rates for individual & HUF b. 40% for foreign companies c. 30% for those not covered above	'Rates in force' as per Part I to the First Schedule of the relevant assessment year's Finance Act

5 Circular No. 636, dated 31-8-1992

It should be noted that under Section 111A, marginal relief is not available for non-resident individuals or HUFs. Further, beneficial slab rates applicable for senior citizens or very senior citizens as per the 'rates in force' are not available for non-residents.

3.3 Long-term capital gains

Section 112(1)(c) read with proviso to Section 112(1) and Section 10(38) provide the tax rates applicable for long-term gains earned by a non-resident.

Type of asset	Applicable tax rates
Unlisted Securities	Up to A.Y. 2011-12: 20% From A.Y. 2012-13: 10%
Listed securities on which STT is not paid on transfer (Lower rate of tax as per Proviso to Section 112(1))	Lower of: 10% tax before availing 'indexation' benefit; or 20% tax after availing 'indexation' benefit.
Listed securities on which STT is paid on transfer	Exempt from tax as per Section 10(38)

Marginal relief available for resident individuals and HUFs is not available for non-residents.

3.4 Lower rate of tax available for "foreign currency" securities?

3.4.1 Proviso to Section 112(1) states that where long-term gains are earned on sale of listed securities or units, the tax rate applicable would be restricted to 10%. This lower rate of tax is applicable on gains computed "before giving effect to the provisions of the second proviso to Section 48", i.e., on gains earned before taking indexation benefit.

The proviso to Section 112(1) has led to a controversy with regard to sale of listed securities or units purchased in foreign currency. As discussed in Para 2.3 above, in case of shares purchased out of foreign currency, adjustment for foreign exchange[6] is applicable and not the indexation adjustment[7].

The controversy

The view taken by the taxpayer is that as such gains are computed after foreign exchange fluctuation adjustment, and without taking indexation benefit; the taxability should be restricted to 10%. In this manner, benefit of both the lower rate of tax, as well as the forex fluctuation adjustment, is obtained.

The tax department's view is that the lower rate of 10% applies only for capital gains where indexation benefit is applicable and can be obtained. If indexation benefit is not available, such long-term gains would be taxable at 20%, and not at a lower rate of 10%.

3.4.2 The above differing stands have led to litigation. Taxation at the lower rate of 10% after foreign exchange fluctuation adjustment has been upheld in quite a few decisions[8] of the Authority for Advance Ruling (AAR) as well as the Income Tax Appellate Tribunal (ITAT).

This view has been upheld by the Hon'ble Delhi High Court in Cairn UK Holdings Ltd.[9] The decision was based on a literal interpretation of proviso to Section 112(1) as against its purposive interpretation. It held that in case the legislature did not intend to provide dual benefits of foreign exchange fluctuation adjustment and

6 As per first proviso to Section 48.

7 As per second proviso to Section 48.

8 Timken France, In re [2007] 164 Taxman 354 (AAR); McLeod Russel India Ltd., In re [2008] 168 Taxman 175 (AAR); Compagnie Financiere Hamon, In re [2009] 177 Taxman 511 (AAR); Alcan Inc. v. DDIT (16 SOT 8).

9 Cairn UK Holdings Ltd. v. Director of Income-tax [2013] 38 taxmann.com 179 (Delhi)

the lower rate of tax, it could have done so by explicitly stipulating the same in the Act. Certain inconsistencies in this interpretation were also held not to be a ground for reading Section 112 differently.

This decision has reversed the ruling of the AAR[10] in the same case, wherein it was held that the words "before giving effect to" used in proviso the Section 112 can come into play only if the assets sold are first qualified for indexation benefit. Thus, the beneficial rate of 10% tax is not applicable for foreign currency securities to which the indexation benefit is not available. This view was also supported in a decision of the ITAT[11].

While the High Court has laid down the favourable position for the taxpayer, one should be careful while obtaining benefit under both provisions. Such an interpretation can lead to litigation.

4. Taxability of Capital Gains under the Double Tax Avoidance Agreements

4.1 Fundamental principles

Capital Gain is discussed in Article 13 of the OECD & UN Models[12]. The Models provide that gains from alienation of assets are taxable in the Country of Residence (COR), i.e., where the seller is a resident. For some assets, Country of Source (COS) is also given the right to tax, i.e., where the asset is situated (situs of asset). Generally, the country, which has the right to tax the income from the asset, is given the right to tax gains from the sale of such assets.

As per the basic principle of International taxation, a Country of Residence always has the right to tax. The Country of Source may be given full / partial / or no rights to tax[13].

In very few DTAAs (e.g., India-UK & India-USA), it is provided that each country can tax capital gains according to its own domestic law.

If the DTAA permits India to tax the capital gains, India can tax it as per its domestic law. The computation, disallowance, exemption, rate of tax, etc., apply as per domestic law. India may tax the gain as capital gain or any other income.

The taxation of Capital Gains is based on the kind of asset sold. The details are discussed with reference to the UN model.

4.2 Immovable property:

4.2.1 Basic rule as per Article 13(1) - Capital Gain earned by a resident of a Foreign Country on sale of immovable property (situated in India), can be taxed in India. The Foreign Country can also tax the Capital Gain.

It is immaterial whether property is residential or commercial. It is also immaterial whether immovable property is a capital asset, or stock-in-trade. The COS can levy tax.

4.2.2 As per Article 13(4), if a non-resident earns gains from sale of shares of the capital stock of a company, or an interest in a partnership, trust or estate; and the property of such a company, partnership, trust or estate consists, directly or indirectly, principally of immovable property situated in COS, the COS can tax the gains. COR can also tax the gains.

It is not necessary that company, partnership, trust or estate should be in India. What is relevant is the situation of property. If the property is in India, and is owned by an Indian entity or a foreign entity; then on sale of shares or interest in the entity, India can tax the income.

10 AAR No.950 of 2010,[2011] 12 taxmann.com 266 (AAR - New Delhi)

11 BASF Aktiengesselschaft vs. DDIT (293 ITR 1)

12 Organisation for Economic Cooperation & Development and United Nations Model Tax Conventions

13 There are however a few old DTAAs where the right to tax Capital gain is only with the Country of Source, e.g., Bangladesh, Greece and Egypt.

India did not tax gains if the shares or interest were outside India as there was no such system in India. However, with effect from A.Y. 2013-14, if immovable property is held through a foreign company, and the value of the share is substantially derived from the value of immovable property, then the shares will be deemed to be located in India. [Explanation 5 to section 9(1)(i)]. Tax will be levied according to the tax payable on sale of shares.

4.3 Movable property owned by a Permanent Establishment or a Fixed Base [Article 13(2)]

Capital Gains earned by a resident, arising from sale of movable property, which is a part of the business property of a permanent establishment (PE) or a fixed base (FB) in India, can be taxed in India. It can also be taxed in the COR. The property would usually be equipments, computers, furniture and other assets used in the business. Most of the assets would form a part of "block of assets" under the Act. Gain would be taxable as short-term gain under section 50 of the Act.

4.4 Ships and Aircraft [Article 13(3)]

Basic rule – If a non-resident earns Capital Gains from sale of:

- ships or aircraft operated in international traffic,
- boats engaged in inland waterways transport, or
- movable property pertaining to the operation of such ships, aircraft or boats.

the same can be taxed ONLY in the Contracting State in which the place of effective management of the enterprise is situated. India CANNOT tax the Capital Gain. This is in line with the taxation of income earned from operating ships and aircraft in international traffic which are taxed only where effective management is situated.

However, immovable property pertaining to operation of ships or aircraft (e.g. office premises in source country), can be taxed under Article 13(1) in COS.

4.5 Shares exceeding certain percentage of investee company [Article 13(5)]

4.5.1 Basic rule – If a resident of Country A sells share of an Indian company, and the shares exceed a certain minimum percentage of investee's capital, then India can tax the gains. Country A can also tax the gains.

The above clause is present in U.N. Model 2001 and most of the DTAAs signed by India. U.N. Model 2011 has a slightly different clause. Please see example below.

This clause is not there in some of the DTAAs entered into by India. Therefore if shares of a company are sold, the COS cannot levy any tax under this clause.

Example

A resident of, say, Country A owns shares equal to 20% of the Indian company's shares. The shareholding prescribed in the DTAA with Country A is say 10%.

If he sells shares equal to 5%, will the same be taxed in source country? The words used are "Gains .... representing a participation of 10% ....". Shares being sold, represent only 5% (less than 10%). Therefore can the source country tax the capital gains? The DTAA or the Commentary does not provide an answer. The purpose appears to be that if there is substantial holding, then source country gets the rights to tax, whatever may be the number of shares sold.

If he sells shares equal to 15%, will the same be taxed in source country? The answer is yes.

4.5.2 The UN Model of 2011 states that if "at any time during the 12 month period preceding such alienation, if the alienator directly or indirectly held at least ____% of the shares", then the same will be taxable in India.

Thus, the minimum percentage criterion has to be considered for 12 months before the

alienation. Also, the shares can be held *"directly or indirectly".* The previous UN model did contain these tests of 12 months and direct and indirect holding.

4.5.3 Some DTAAs have a slightly modified clause. As per the India-Netherlands DTAA, ***"alienation of shares…which form part of at least a 10 per cent interest in the capital stock of that company, may be taxed in that other state if the alienation takes place to a resident of that other State."*** Therefore, when a sale takes place of even one share of an Indian company, which forms part of at least a 10% holding, India can also tax such transfer. However, such gain is taxable in India only if sale is to a resident of India.

4.6 Other property [Article 13(6)]:

Basic rule – If a resident of a foreign country sells any property other than those mentioned in the above paras, it is taxable only in that foreign country. India cannot tax the same. This is the residuary clause. Some assets which can fall under the residuary clause are know-how, units of a mutual fund, bullion, etc. Sale of these assets will not be taxable in India.

This residuary clause in Mauritius, Singapore and some other DTAAs has been used to claim relief from taxation on Capital Gain in India on sale of shares, as shares in general fall under the residuary clause in these DTAAs.

4.7 Issues under some Indian DTAAs

4.7.1 Situation where there is no Article for Capital Gains in a DTAA

The DTAA which India has signed with Malaysia in 2001 (notified in 2004) does not contain any Article on Capital Gain. In such a case, we have to consider Article 21 (other income). As per Other Income Article, ONLY COR has the right to tax. COS does not have the right to tax. But some Indian DTAAs – specially the new ones (including the India-Malaysia DTAA of 2001), provide that if the income arises in COS, then income can be taxed in COS. Whether income is considered to arise in COS, depends on domestic law of the COS. For example, if the asset is situated in India, India will be able to tax such gain.

4.7.2 Mauritius DTAA

India's DTAA with Mauritius has led to several controversies. As per Article 13(4) of the DTAA, the right to tax capital gains derived by a resident of Mauritius is only with Mauritius. India does not have a right to tax such gains. Further, capital gains are not taxable in Mauritius as per its domestic tax laws and thus, a Mauritius tax resident earning capital gains in India does not have to pay tax in either country. For example, shares of an Indian company sold by a Maurtian tax resident would not suffer any tax in either country. Therefore, Mauritius has been a preferred tax jurisdiction for inbound investments.

There has been considerable litigation on this benefit of **double non-taxation** enjoyed under this DTAA. The tax authorities have alleged that investors using the India-Mauritius DTAA are indulging in **treaty shopping** as they lack commercial substance in Mauritius. The CBDT in its Circular No. 789 stated that wherever a Tax Residency Certificate is issued by the Mauritian Revenue Authorities, it will be sufficient evidence for residence and beneficial ownership for applying the provisions of the DTAA. The Supreme Court in Azadi Bachao Andolan[14] upheld the validity of this circular.

However, in the recent case of **Aditya Birla Nuvo**[15], the Bombay High Court has held that, based on the facts of the case, even though the Mauritian company was the registered owner of the Indian company's shares, it could not be regarded as the legal/beneficial owner of the

14 Union of India vs. Azadi Bachao Andolan (2003) 263 ITR 706 (SC)

15 Aditya Birla Nuvo Ltd vs DDIT 342 ITR 308 (Bom)

income accruing thereon. The Court further held that both the circular and the Supreme Court decision in Azadi Bachao Andolan are not applicable to the facts of the case as the gains may not have arisen to a Mauritius taxpayer.

Therefore, the issues under the Mauritius DTAA stay alive and clarity may come only once the DTAA is revised.

4.7.3 Singapore DTAA

Singapore DTAA has a favourable clause for gain on sale of shares. If a resident of Singapore sells shares of an Indian company, the gain is not taxable in India[16]. I understand that it was brought about at the request of Singapore Government as Mauritius DTAA has a similar benefit.

There is however a **Limitation of Benefits** clause (LOB clause) which was also brought about at the same time[17]. The LOB clause applies to sale of other assets (which include shares) not covered in Articles 13(1) to 13(3) of the main DTAA. The LOB clause provides for the certain tests, which are discussed below:

As per clause (1) of the LOB clause, the benefit of exemption of tax in India of Capital Gain will not be available if the **affairs** of the Singapore resident are *"arranged with the primary purpose to take advantage of the benefits in Article 1 of this Protocol."*

Clause (2) of the LOB clause provides that a **shell/conduit company** which claims to be a resident of Singapore, will not be entitled to the benefits of Capital Gain relief. It may be noted that this is an independent test, not related to the first test of "Affairs".

A shell/conduit company (shell company) is any legal entity *"with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State."* This test applies to any legal entity and not just a company. There are tests for deeming a company as a shell company. These are given in clauses (3) and (4) of the LOB clause.

Clause (3) provides that the entity will be a shell company if its total annual expenditure on operations in Singapore is less than S$ 200,000 in Singapore. Thus if the company is to be considered as a *bona fide* company for this clause, it must spend at least S$ 2,00,000 per year on its operations in Singapore. The expenditure has to be incurred over a period of 2 blocks of 12 months immediately preceding the month in which the Capital gain arises.

Clause (4) provides that the entity will not be a shell company if:

- it is listed on a recognised stock exchange in Singapore; and
- the total annual expenditure on the operations is at least $ 2,00,000 in the immediately preceding 24 months from the date of sale.

It is a general understanding that if the Singapore company incurs expenditure of S$ 2,00,000 on operations in Singapore, then the DTAA should apply. **However is that sufficient?**

Explanation provided at the end of the LOB clause provides that the case of entities not having *bona fide* business shall be covered by clause (1) mentioned above. As discussed earlier, clause (1) provides for the test based on "**affairs**" of the person. Thus, even if the company is not a shell company (as it satisfies the tests laid down in clauses (2) to (4) of the LOB clause), it could still be considered as a company whose **affairs** are arranged to take advantage of the capital gain tax relief. Hence, LOB clause can be applied, resulting in denial of the DTAA benefit.

16 Article 1 of the Protocol signed between India and Singapore on 29th June, 2005 with effect from 1st August 2005.

17 Article 3 of the Protocol signed between India and Singapore on 29th June, 2005.

4.7.4 Cyprus DTAA

The India-Cyprus DTAA also provides for similar benefits on capital gains as the India-Mauritius DTAA. Therefore, no tax is payable in India on sale of shares in an Indian company by a tax resident of Cyprus.

However, recently, the CBDT has notified Cyprus as a **"Notified Jurisdictional Area"** under Section 94A[18]. In other words, Cyprus has been listed as a non-co-operative jurisdiction and the applicable anti-tax avoidance provisions come into effect from the date of this notification, i.e, from 1st November, 2013 on all transactions with Cyprus. The implications of this notification have been summarised in a Press Release[19]. Provisions relevant for capital gains are:

- All parties to transactions with a person in Cyprus shall be treated as associated enterprises and the transfer pricing provisions will accordingly apply. Additional documentation as prescribed will be required to be maintained.
- Any payment on which tax is deductible at source and made to a person located in Cyprus, will be liable for deduction of tax at source as per the rates under the Act or 30%, whichever is higher.

Impact on gains not taxable under the DTAA?

Section 94A prescribes additional requirements to be applied on transactions with Notified Jurisdictional Areas. However, it does not deny the benefits available under the DTAA. As mentioned earlier, capital gains earned in India will not be taxable in India as per the DTAA with Cyprus.

Therefore, the above provision for deduction of tax at source at higher rate will not apply to such capital gains. In my view, while this stand is correct, it should be noted that once these anti-tax avoidance provisions are enforced, the transactions will be scrutinised thoroughly. An Indian resident must obtain and maintain all required details for even tax exempt transactions.

4.7.5 UAE DTAA

The India-UAE DTAA had a beneficial clause for taxation of shares. If the UAE resident earned capital gain on sale of shares, it was not taxable in India. However in March 2007, the DTAA has been amended by a protocol. As per the protocol, capital gain earned on sale of shares will be taxable in India.

4.8 Overall, the DTAAs generally do not give any benefit for immovable properties situated in India, or for properties of PEs in India. However, significant benefits may be available for capital gains on sale of shares under certain DTAAs.

Impact of DTAAs on taxation of FIIs is dealt with in para 6.2 and their impact on taxation of 'indirect transfers' is discussed in detail in para 11.7.

5. Special provisions for gains earned by Non-resident Indians

Non-resident Indians (NRIs) have enjoyed a beneficial tax treatment in India as compared to other non-residents. While the general provisions explained above are equally applicable to NRIs, special provisions of Chapter XII-A – Sections 115C to Section 115-I – are applicable for taxation of certain incomes earned by NRIs.

5.1 Applicability of Chapter XII-A:

Assets covered	Incomes covered	Tax rate
'Specified assets' if purchased, acquired or subscribed to in convertible foreign exchange: a. Shares in an Indian company; b. Debentures in or deposits with an Indian company which is not a private company; and c. Specified Government securities.	a. Investment income which is defined as income derived from the specified assets, but excluding dividends referred to in Section 115O	20%
	b. Long-term capital gains	10%

18 Notification No. 86/2013 dated 1st November, 2013

19 Press Release issued by the Ministry of Finance dated 1st November 2013

5.1.1 As discussed in the preceding paragraphs, long-term capital gains earned on sale of listed securities where STT is paid are exempt from tax under Section 10(38). Long-term gains earned on transfer of unlisted securities are taxable at 10% as per Section 112. Further, benefits of slab rates are not available under both Section 115E and Section 112.

Therefore, Chapter XII-A benefits are now restricted to a narrow range of long-term gains – those earned on listed securities which are not exempted under Section 10(38), i.e., which are not traded on a stock exchange. As per Section 112(1)(c)(ii), such gains are taxable at 20% as compared to 10% under Section 115E.

5.2 Issues

5.2.1 Deposits held with banking companies

There is an issue on whether specified assets being 'deposits with an Indian company' include deposits held with banking companies. Under Chapter XII-A deposits with companies other than 'private companies'[20] are covered. Banks are companies, though regulated under the Banking Regulation Act. Further, most Indian banks are public companies. They are not private companies as per the definition under the Companies Act. Therefore, deposits with banking companies should be covered under Chapter XII-A. Judicial precedent[21] in this matter also supports this view.

However, deposits with branches of foreign banks would not get covered under the above definition as these foreign branches are not 'Indian companies'.

5.2.2 Are short-term gains covered?

There is a controversy on whether 'investment income' includes short-term gains earned on sale of specified assets. As per a judicial precedent[22] short-term gain falls within the definition of 'income' as per the Act, and hence would be covered under the definition of 'investment income'.

However, the Mumbai Tribunal in *Sunderdas Haridas v. ACIT*[23] has held that 'investment income' does not cover short-term capital gains. The reasons for such a decision are:

a. 'Investment income' is to be considered as a phrase distinct from the definition of 'income' in the Act. While the 'income' definition covers capital gains, the same cannot be covered under the phrase 'investment income'.

b. If benefit was to be provided to short-term capital gains, the same would have been specified in the Act clearly as is done in other sections.

c. The exclusion of short-term gains from the benefits of Section 112 is with the specific purpose to restrict the outflow of hot money. The concessional tax rate is extended to traders or investors who are dedicated to the Indian market for a sufficiently long time thus deriving income like dividends, interest, or long-term capital gains.

d. "Income derived from any asset" should flow from the use of the asset, and not from capital realisation on sale of the asset. The legislature did not intend to give benefit to short-term capital gains although short-term capital gains for the purposes of the Act remains part of 'total income' within the meaning of Section 2(45).

In my view, the decision of the Mumbai Tribunal is correct. If benefit of lower rate of tax was to be provided to short-term capital gains too, it should have been specifically mentioned in the Section.

20 As defined under the Companies Act

21 V. Ravi Narayanan, In re [2008] 168 Taxman 65 (AAR).

22 Smt. Trishla Jain [1990] 34 ITD 523 (Delhi)

23 [1998] 67 ITD 89 (Mum.)

6. Taxability of gains earned by FIIs

Foreign Institutional Investors (FIIs) have had a chequered past with the Income-tax authorities in India. While the Income-tax Act has provided for streamlined provisions for taxation of FIIs, there have been several attempts to bring to tax the incomes earned by FIIs to tax at higher rates. There has been a "tug-of-war" between the FIIs and the tax department.

6.1 Taxability under the Income-tax Act

Under the Income-tax Act, taxation of FIIs is governed by Section 115AD. Sub-accounts of FIIs would also get covered under Section 115AD.

As per the Advance Ruling in Universities Superannuation Scheme Ltd.[24], Section 115AD is a self-contained code for purposes of determining computation and taxability of incomes of FIIs. FIIs cannot opt for being taxed under the normal provisions of the Income-tax Act.

6.1.1 Tax rates for Capital Gains

This Section provides tax rates for capital gains which are largely in line with the general provisions.

Type of asset	Short-term Gains	Long-term Gains
Equity shares or units of an equity-oriented fund, on which STT is paid, i.e., which are sold on the stock exchange	15%	Exempt u/s. 10(38)
Capital assets other than those mentioned above. Off-market sale of listed equity shares and units of equity-oriented fund are also covered here	30%	10%

The major difference in the above tax rates is for short-term gains on which STT is not paid. While for foreign companies the tax rate for such gains would be 40%, FIIs are taxable only at 30%.

It should be noted that as per Section 115AD(3), the computation of capital gains has to be done without taking into effect the first and second provisos to Section 48.

6.2 Taxation under the treaties

FIIs which are tax residents of countries with which India has signed DTAAs can take benefit of the provisions of the DTAAs or the Act whichever are more beneficial. The benefits generally available to FIIs under the treaties are:

6.2.1 If the income is considered as Capital Gain, then the same may be taxable in India according to most of the DTAAs. However as per some of the DTAAs like Mauritius, Singapore and Cyprus, the Capital Gain will be taxable only in those countries as COR. As these countries have no tax on Capital Gains under their respective domestic tax laws, the gains can be earned tax free.

6.2.2 If the income is considered as Business Income, then in absence of a PE in India, India cannot tax the income. It is an accepted fact that if one conducts the transactions in a manner whereby it amounts to trading, then the income will be considered as business income.

Different FIIs have taken different stands – Capital Gains or Business income – and succeeded to have tax free incomes under both claims.

6.3 Deductibility of tax at source

While Section 195 is applicable for all payments to non-residents, Section 196D specifically deals with deduction of tax at source from incomes

24 275 ITR 0434

earned by FIIs. Therefore, for incomes covered under Section 196D, deduction of tax at source will not be determined as per Section 195.

Section 196D provides that no tax is required to be deducted at source from capital gains earned by FIIs. Therefore, short-term capital gains or long-term capital gains, which may otherwise be taxable in India, can be paid to an FII without deduction of tax at source.

However, it should be noted that FIIs are still responsible for paying any tax on such incomes in their own capacity by filing their tax returns.

6.4 Capital Gains vis-à-vis Business Income

6.4.1 The major issue that arises in taxation of incomes earned by FIIs is whether the income is in the nature of capital gains or business income. As tax rates applicable can be quite different for business incomes as compared to capital gains, there is litigation on this issue.

6.4.2 The determination of the issue - whether incomes earned are business income or capital gains is based on the intention of the assessee at the time of investing in capital asset. If the investment was in the nature of trade, it is considered as business income. If the intention was to hold on and earn income and appreciation, it is considered as investment. The determination of the intention is largely based on facts and conduct of the income earner. There are a number of decisions[25], including those of the Supreme Court, which have brought out the factors on which this demarcation needs to be done. The CBDT has also issued a circular[26] supplementing its earlier instruction[27] bringing out these factors. The main factors are:

- Whether the activities are regular and allied; or occasional and incidental?
- Whether the number of transactions is substantial?
- Whether the intention to invest is to earn dividends or profits on sale?
- Whether the treatment in books is as investments or stock-in-trade?
- Whether own funds are utilised or borrowed funds?

It should be noted that there can be a number of other factors; and that this issue needs to be decided based on a cumulative reading of all the factors and not any one of them.

6.4.3 The decisions which have dealt with this issue in relation to FIIs have brought out **additional factors** that can determine the nature of income earned.

In the case of Fidelity Advisors[28] and XYZ/ABC Equity Fund[29], the Authority ruled that the transactions by the FIIs amounted to business income. Article 7 of the relevant DTAA will apply. In absence of a PE in India, the income cannot be taxed in India. Similar view was adopted in a few other decisions[30].

However subsequently in the advance ruling of Fidelity North Star Fund[31], it has been held that the income on sale of securities will be considered as Capital Gain. The reason was that the under SEBI[32] Regulations, an FII can only 'invest' and not do 'business'. Hence, FIIs can only earn dividend and capital gain. One

25 Sarder Indra Singh & sons Ltd. v. CIT (1953) (24 ITR 415); G.Venkata Swami Naidu &Co. vs. CIT (1959) (35 ITR 594);Karam Chand Thapar and Brothers (P) Ltd vs. CIT (1971) (83 ITR 899); Commissioner of Income Tax vs. Associated Industrial Development Company (P) Ltd (82 ITR 586); Commissioner of Income Tax, Bombay vs. H. Holck Larsen (160 ITR 67).

26 Circular No. 4/2007 dated 15th June 2007

27 Instruction No. 1827 [F. No. 181/1/89-IT(AI), dated 31-8-1989

28 271 ITR 1

29 250 ITR 194

30 General Electric Pension Trust (280 ITR 425), Royal Bank of Canada (323 ITR 380)

31 288 ITR 641

32 Securities Exchange Board of India

cannot presume that FIIs took approvals with an intention to violate the laws by trading in securities.

In *L.G. Asian Plus Ltd. vs. ACIT*[33], the Mumbai ITAT has provided the same reasoning as in Fidelity North Star Fund to hold that income earned by FIIs on transfer of securities would be taxable as capital gains under Section 115AD. However, it has proceeded further to state that in a hypothetical case where an FII does earn 'business income' it would be taxable under the general provisions only if such income was earned on transfer of assets other than 'securities'. Therefore, as per the ITAT, in case of transfer of securities held as stock-in-trade or investments, income would be taxable as capital gains under provisions of Section 115AD.

In my humble view, with respect, tax laws and regulatory laws have different objectives. Approval obtained under regulatory laws does not impact taxation of income. One has to ultimately look at the facts. If the transactions are conducted in a manner which amounts to trading, it is immaterial as to what kind of approval was obtained. The income should be considered as business income.

However in case of Fidelity North Star Fund, it was the department's stand that the income of the FIIs is Capital Gain in nature. Even in the proposed Direct Tax Code, it has been provided that the sale of shares by FIIs will amount to Capital Gain. Thus it appears that the revenue department wants to consider the income of FIIs as Capital Gain.

6.4.4 Taxation of gains on derivatives

While the above paragraph dealt with income earned on sale of capital assets like shares and units; taxation of income on transfer of derivatives has brought out a slightly different issue. Trading in derivatives was covered under 'speculative transaction' as per Section 43(5) of the Act. An amendment was brought in from 1st April, 2006 excluding transactions in respect of trading in derivatives from 'speculative transactions'. This resulted in income earned on trading in derivatives to form part of 'business income'.

In quite a few cases, FIIs had submitted income on trading in derivatives under the head 'Capital Gains' instead of 'Business Income'. The tax department had contested these claims.

In the recent decision of Platinum Asset Management Ltd.[34], the ITAT held that as derivatives are covered within the definition of 'securities' mentioned in Section 115AD, the income would be determined as per Section 115AD, and not as per the general provisions. As Section 43 defines terms used under the head 'Incomes from Business or Profession', the definition of 'speculative transaction' therein would not be applicable for transactions of derivatives covered under Section 115AD. The ITAT took support of its earlier decision in *L.G. Asian Plus Ltd. v. ACIT*[35] mentioned above. A similar decision was provided for the same assessee for a different assessment year[36]. Further, the judgement of the Bombay High Court[37] on derivatives being taxed as "business income" was not relied upon by the ITAT as its ratio could not be applied in case of an FII.

Therefore, the legal position presently is that income on transfer of derivatives would be brought to tax under Section 115AD as capital gains and not as business income under Section 28.

33 [2011] 11 taxmann.com 414
34 I.T.A.No.2787/M/2012
35 [2011] 11 taxmann.com 414
36 ITA No.3598/Mum/2010dated 5th December 2012.
37 CIT v. Bharat R. Ruia (HUF) 337 ITR 452 (Bom)

7. Taxability of gains on transfer of bonds and GDRs

7.1 To enable foreigners to invest in Indian companies without having to be involved with the Indian capital market, the Government has come out with a scheme[38] under which the Indian company issues shares or convertible debentures / bonds in foreign currency. The shares / bonds are issued in the official name of an Indian depository / custodian. Under a back-to-back arrangement, an overseas depository issues Global Depository Receipts (GDRs) to the non-resident investors. GDRs include American Depository Receipts (ADRs). These receipts are tradable on an overseas exchange.

In essence the investment is in shares or bonds of an Indian company, but through GDR mechanism. However as they are independently tradable, they are like simple derivative instruments.

In 2008, the Government came out with "Foreign Currency Exchangeable Bonds Scheme 2008" (FCEB). Under this scheme, the FCEBs are issued by the Indian company to non-residents under the GDR mechanism. The non-resident can exchange the bond, with the equity shares of a listed company, which is held by the FCEB issuing company (the issuing company and the listed company have to belong to the same group). Thus bonds are "exchanged" for shares. The strength of the listed company is used to raise funds by a group company.

7.2 Section 115AC deals with taxation of incomes earned on bonds of Public Sector Undertakings (PSUs), and GDRs purchased by non-residents out of foreign currency. The incomes covered are dividend (other than on which Dividend Distribution Tax (DDT) has been paid), interest and long term capital gain. **Long Term Capital Gain is taxable @ 10%.** Practically there are not many issues regarding taxation of income on GDRs. The section and the scheme grant certainty. The tax regime of GDRs is running smoothly.

7.3 Capital gains related to GDRs

There can be three taxable events in case of GDRs. The taxability which can arise at each event is mentioned below:

7.3.1 On trading in GDRs

If the transfer happens outside India, there is no tax, provided that the transaction is between two non-residents. The scheme and Section 47(viia) clearly state this. Long-term gain & short-term gain – both are exempt from tax – on transfer of GDRs.

7.3.2 On conversion of GDR into underlying share

If the GDR is converted into shares by the investor, then it may amount to a gain on exchange. But the scheme is silent. It in fact proceeds on the assumption that only when the converted shares are sold, there is a tax. The appreciation or depreciation before conversion is ignored. Please refer para 7.5 below.

7.3.3 On sale of underlying shares

General provisions of the Act would apply in this case.

7.4 What happens if GDRs are transferred to Indian residents?

Earlier GDRs could not be sold to residents due to regulatory issues. However, under the Liberalised Remittance Scheme of FEMA[39], an Indian resident can now buy foreign securities up to the prescribed limit. Even Indian mutual funds have been recently permitted to buy the GDRs.

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38 "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993"

39 Foreign Exchange Management Act

The scheme and section 47(viia) of the Act exempt gains on transfer of GDR from one non-resident to another non-resident. Does it mean that a transfer to a resident is taxable?

If the non-resident sells the shares to an Indian resident, there can be a tax issue if we consider the GDR to represent Indian securities. As STT would not have been paid, there can be a tax on it.

If GDR is considered to be an independent security, there should be no tax, as the transaction takes place outside India.

The problem is if the GDR was sold on the overseas stock market, how will the non-resident investor know who is the buyer! From the buyer's angle, how will he know who is the seller! Can the Indian department state that the Indian buyer is the agent of the non-resident u/s. 163? The answer is yes. It has also been confirmed in the Advance Ruling of Trinity Corporation[40].

If yes, how would he know who is the seller? Which DTAA is to be considered? Is it long-term gain or short-term gain? What is the cost, etc.?

In my view, the entire scheme is such that GDRs are considered as independent of the underlying securities. They are foreign securities, traded outside India. Hence there should be no tax payable by a non-resident on sale to an Indian resident.

However, due to the recent amendment in Section 9, shares traded outside India, which derive their substantial value from assets located in India, would be deemed to be situated in India. This can lead to taxation of GDRs, even if they are considered to be an independent security. However, in my view, as there is a specific exemption for trading in GDRs by non-residents, there should be no tax liability due to the amended provision of Section 9 also.

7.5 Cost and the period of holding of shares obtained on conversion of GDRs

GDRs can be converted in to their underlying shares. On eventual sale of such shares, there is an issue of what should be the cost and period of holding of such shares.

7.5.1 Cost of underlying shares:

Section 49 strictly does not apply to conversion of GDRs. Section 55 also does not refer to such conversions. Clause 7 of the scheme states as under:

> *"(3) On redemption, the cost of acquisition of the shares underlying the Global Depository Receipts shall be reckoned as the cost on the date on which the Overseas Depository Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.*
>
> *(4) For the purposes of conversions of Foreign Currency Convertible Bonds, the cost of acquisition in the hands of the non-resident investors would be the conversion price determined on the basis of the price of the shares at the Bombay Stock Exchange, or the National Stock Exchange, on the date of conversion of Foreign Currency Convertible Bonds into shares."*

Thus the cost has to be considered as the price on the date on which the GDRs or FCCBs are converted. If the shares are sold immediately on conversion, then there may hardly be any capital gain. **In other words, the appreciation or depreciation while the security is a GDR, is ignored.**

The overall scheme is that as long as GDRs are not converted into underlying securities, they remain outside the tax net. Therefore to take

40 AAR No. 740 of 2006.

the view that cost of share should be the cost of GDR will not be possible.

7.5.2 Period of holding:

For the purpose of determining the period of holding of shares, clause 9 states as under:

> *"(4) If any capital gains arise on the transfer of the aforesaid shares in India to the non-resident investor, he will be liable to income-tax under the provisions of the Income-tax Act. If the aforesaid shares are held by the non-resident investor for a period of more than twelve months from the date of advice of their redemption by the Overseas Depository Bank, the capital gains arising on the sale thereof will be treated as long-term capital gains and will be subject to income-tax at the rate 10 per cent under the provisions of Section 115AC of the Income-tax Act. If such shares are held for a period of less than twelve months from the date of redemption advice, the capital gains arising on the sale thereof will be treated as short-term capital gains and will be subject to tax at the normal rates of income-tax applicable to non-residents under the provisions of the Income-tax Act."*

The date of holding is considered to be from the date of redemption advice by the overseas depository.

7.6 Capital gains on sale of PSU Bonds

On sale of bonds of PSUs, if there is a long-term gain, the tax is 10%. On short-term gains, the tax is 30% / 40%.

If the bonds are listed, then the period of holding should be more than 12 months to qualify as long-term. If the bonds are unlisted, the period is 36 months.

8. Taxability of gains earned by QFIs

8.1 Qualified Financial Investors are a new category of foreign investors, recently permitted under SEBI and RBI[41] to invest in the capital market in India. The definition of 'QFIs' under the SEBI Regulations includes all 'persons' as defined in the Income-tax Act and FEMA. Further such person needs to be a non-resident of India as per the Income-tax Act and FEMA; and a 'resident' of a country specified in these Regulations as per its domestic tax laws. It specifically excludes FIIs, their sub-accounts and FVCIs.

8.2 The Income-tax Act has not provided any relaxation or special provisions for incomes earned by QFIs. Hence, QFIs would be taxable as per the general provisions depending on the type of investor. This results in a significant difference in taxation, as FIIs are taxed at a lower rate, as also enjoy exemption from deduction of tax at source. QFIs do not have any such relief.

8.3 The CBDT has released FAQs on various aspects related to QFIs. It provides the procedure by which taxes are required to be deducted at source on incomes earned by QFIs. QFIs are to operate in India through their Qualified Depository Participants (QDPs) – a financial intermediary registered with the SEBI. The QDPs have been assigned the responsibilities regarding deduction of tax at source from amounts remitted to the QFIs. QDPs will be treated as a representative assessee / agent of the QFI. The QDP must ensure that the broker deducts appropriate tax, failing which the QDP must deduct the taxes.

The FAQs provide the manner in which incomes are to be computed at the time of deduction of taxes at source. The QFIs will be required to file a tax return to claim the benefits as per the Act.

9. Taxability of gains earned by FVCIs

9.1 Foreign Venture Capital Investors (FVCIs) are registered under the SEBI Regulations for investment in securities of

41 Reserve Bank of India

Indian companies. FVCIs enjoy relaxed pricing norms and lock-in period as compared to other investors.

9.2 Like QFIs, FVCIs also do not enjoy any special taxation policies or rates. Incomes earned by them are subject to tax rates as per the type of income and the nature of entity through which they are investing in India.

However, for investments made by them in Domestic Venture Capital Companies (DVCCs) or Domestic Venture Capital Funds (DVCFs), FVCIs can earn incomes without taxation at two levels. This is because DVCCs and DVCFs are treated as pass-through entities for incomes earned by them from investment in a Venture Capital Undertaking (VCU) as per Section 10(23FB) of the Act. Therefore, capital gains earned by DVCCs and DVCFs on sale of shares in VCUs would directly be taxable in the hands of FVCIs.

This also entails on them a responsibility to pay appropriate taxes on such gains in India. Further, as per Section 10(23FB), FVCIs need to pay tax on income earned by the DVCF or DVCC on an accrual basis, irrespective of when the income is received by the FVCI.

9.3 FVCIs which invest through tax efficient jurisdictions, avail of the benefits of tax treaties signed by India with such countries.

10. Taxability of gains earned by Offshore Funds

Income of Offshore Fund is entitled for special tax treatment on Mutual Fund Dividend & long-term Gain on units of mutual funds as per Section 115AB.

10.1 An Offshore Funds is an "overseas financial organisation" - a fund, institution, association or body, whether incorporated or not, established under the laws of a country outside India. It should have entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D). The arrangement should be approved by the SEBI.

10.2 Applicability of Section 115AB to capital gains

Investments covered	Incomes covered	Tax rate
The investments covered are in units of a mutual fund as specified under section 10(23D) or of the Unit Trust of India; and should be in foreign currency	Long-term capital gains	10%

10.2.1 Long-term gains are exempt from tax under section 10(38), if the units are of "equity oriented mutual fund" and STT is paid. Therefore the relief granted by this section is redundant in case of such gain.

However, long-term capital gain on units of "non-equity oriented mutual fund", are taxable under this section @ 10%.

Other incomes like short-term capital gains are taxed as per normal provisions.

No deduction of expenses and no deduction under Chapter VI-A is allowed.

10.3 Applicability of Section 112

Long term capital gain on listed units of "non-equity oriented mutual fund" are taxable under this section @ 10%. The second proviso to section 48 is not applicable, i.e., inflation adjustment provisions do not apply[42].

Under section 112, the tax on Long Term Capital Gain on such units is 20%. Compared to a tax of 20% under section 112, the tax under section 115AB is 10%. But if the tax @ 20% after inflation adjustment is less than tax @ 10%, without

42 As per Section 115AB(2). First proviso to section 48 (foreign exchange fluctuation adjustment) does not apply to units in any case.

inflation adjustment, can the offshore fund pay lower of the two?

In my view, the answer is no. This is a specific section and overrides the general section. The principle laid down in Advance Ruling (that specific sections override general provisions) referred to in para 6.1 can equally apply here.

10.4 Therefore, in conclusion, there do not seem to be any benefits to offshore funds which are covered under Section 115AB. However, as there is no provision for these funds to opt out of this Section, taxability of gains earned by such funds will be determined as per Section 115AB.

11. "Indirect transfers" – Taxability and issues

11.1 'Indirect transfers' are used to describe transactions where overseas assets are transferred leading to a transfer in value of the underlying Indian capital assets. While in form there is no transfer in India, in substance there is a transfer. These transfers can lead to taxation in India as per recent amendments.

11.2 The reason for such amendments was the Supreme Court's decision in favour of Vodafone International Holdings B.V.[43]. In this decision the Supreme Court held that Hutchison's sale of one share of a Caymans Island company outside India, which led to transfer of its entire Indian telecom business to Vodafone B.V., will not be liable to tax in India. The Supreme Court's decision was based on the reasoning that in a transfer of an overseas asset outside India, one cannot adopt a 'look through' approach to tax the underlying assets in India. Based on several factors, it also upheld the transfer as genuine and not as a colourable device used to avoid tax.

11.3 The Government came out with a slew of amendments to counter this decision. As the Supreme Court held that such income was not within the scope of taxable income under the Act, the Government amended the scope itself.

Section 9(1)(i) lays down that income arising or accruing, directly or indirectly, **through** the **transfer** of a **capital asset situated in India** would be deemed to accrue or arise in India.

The enabling provision to tax income on such transfers was brought through Explanation 5 to Section 9(1)(i) which stated that:

Any share or interest in a foreign company was deemed to be situated in India if the share or interest derives, directly or indirectly, its value substantially from assets located in India.

Further, amendments in the expression "through" used above; in the definition of 'capital asset' under Section 2(14); and in the definition of 'transfer' under Section 2(47); were also made to enable the above deeming provision; and to counter some other rulings laid down by the Supreme Court.

All the above amendments were brought in with retrospective effect from 1st April, 1962 and as 'clarifications' to existing law.

11.4 "Assets" deemed to be situated in India:

The important distinction to be noted in this amendment is that instead of deeming the **capital gains** that would be earned on such 'indirect transfers' to be within the scope of the Act, the overseas assets which would get transferred are itself deemed to be situated in India. This leads to a change in the fact pattern itself, though of course only for tax purposes. This can lead to a number of issues, some of them probably unintended.

If tax is payable in the foreign country on such transfer, there can be double taxation. Tax credit may not be available for such double taxation as both countries would claim a right to tax such income.

43 Vodafone International Holdings BV vs. Union of India [2012] 341 ITR 1 (SC)

Further, while the provisions are aimed at taxation of capital gains, any other incomes earned on such assets may also be taxable within India. For example, dividends declared on such foreign shares can be taxable in India, as the shares will be deemed to situated within India.

11.5 There are several other concerns raised on certain aspects of these amendments. Particularly, clarity is desired on the following aspects:

- What does one mean by 'substantial' value. Is it more than 50% or is it something close to the entire value?
- In case tax is levied on such overseas transfers, what would be the taxation when the underlying Indian capital assets are sold? Whether credit would be available for taxes already paid?
- There are ambiguities on how computation would be done for such gains in India, especially where the assets sold overseas represent both Indian and foreign assets, and value is not ascribed separately.
- This provision is aimed at restructuring exercise or outright sale. However, technically this provision applies to even one share sold by a retail investor outside India which has it values based on Indian capital assets. How can a person operationally comply with such a provision?
- Group reorganisations can also lead to taxation under Section 9 even though Indian capital assets are transferred as part of overseas assets.

11.6 A Committee under the Chairmanship of Dr. Shome was established to deal with these issues. The Committee has submitted its final report recommending several changes in these amendments. In its draft report, the Committee has suggested that:

- A threshold of 50% should be applied for the word 'substantially'.
- The phrase 'directly or indirectly' should be applied as a 'look through' approach, whereby all intermediaries should be ignored.
- Investments made by non-residents through FIIs should be exempted from such a tax.
- Transfer of shares on approved stock exchanges where such shares are frequently traded should also be exempted from these provisions.

11.7 Relief available under the DTAA?

Unlike certain other provisions[44], the amendments made in Section 9 are not 'non-obtstante' provisions. In other words, they do not override the DTAA. Therefore, wherever the DTAA provides a benefit, as per Section 90(2) the taxpayer can still opt for taxation under the DTAA. As seen in Para 4 above, transfer of shares (not otherwise covered) are taxable only in the COR. In certain DTAAs this results in double non-taxation. This benefit can be availed by non-residents taxed on their indirect transfers too.

In Sanofi Pasteur Holding SA[45], two French companies (MA & GIMD) had sold the shares of another French company (ShanH) to a third French company (Sanofi Pasteur Hoding). ShanH in turn held shares of the Indian company Shantha Biotechnics Ltd.

As per Article 14(5) of the DTAA, capital gains on such transfers outside India were not liable to tax in India. Upholding the principle in Section 90(2), the Andhra Pradesh High Court has held that in absence of a non-obstante clause,

44 Like Section 206AA of the Act with regard to holding of PAN.

45 Sanofi Pasteur Holding SA vs. Department of Revenue[2013] 30 taxmann.com 222

the retrospective amendments under Section 9 cannot override provisions of the DTAA.

Therefore, the impact of these amendments to Section 9(1)(i) will be limited wherever a beneficial DTAA is available.

12. Deductibility of tax at source from capital gains

As per Section 195, tax is required to be deducted at source from "sums chargeable to tax" before making the payment to a non-resident. Deduction has to be only on "sum chargeable to tax". Therefore, where the payment does not include any income chargeable to tax, no deduction of tax at source is required. While there are many issues related to deduction of tax at source, the main points in relation to capital gains earned by non-residents are as follows:

12.1 Deduction of tax on capital gain or gross consideration?

There is a concern whether tax is required to be deducted under Section 195 only on the capital gain, or on the whole amount of consideration paid to a non-resident. This issue has come up time and again before judicial authorities. The Karnataka High Court in Samsung Electronics Co. Ltd.[46] held that deduction of tax at source was required on each remittance on the gross sum payable. It incorrectly applied the Supreme Court ruling in Transmission Corpn. of AP Ltd.[47] that at the time of deduction of tax at source, the taxpayer needs to obtain an order under Section 195(2) to determine the amount of taxable income forming part of a composite payment.

The Supreme Court in GE India Technology Cen. (P.) Ltd.[48] has corrected this ruling and held that *"The obligation to deduct tax at source is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident."*

However, there are a couple of recent decisions of the Bengaluru Tribunal which have not applied the above Supreme Court ruling. In Syed Aslam Hashmi[49], the ITAT taking support of the Karnataka High Court decision in Samsung Electronics, has held that tax needs to be deducted at source on the whole of the consideration.

In R. Prakash[50] the ITAT has upheld the computation of interest under Section 201(1A) on tax payable on the whole amount of consideration instead of on the amount of gain.

In my humble view and with respect, both the above decisions of the Bengaluru Tribunal are not correct in law as they have not considered the decision of the Supreme Court in GE Technology Cen. P. Ltd., which has clearly stated that deduction of tax at source is required only on the portion of income embedded in the payment.

12.2 Can the payer himself determine the amount of tax to be deducted at source?

The payer needs to determine the amount of capital gains earned by the payee and deduct appropriate tax at source. Determination can be difficult in certain cases, especially where capital gains are earned. However, the payer can, if proper details are available, compute the gain and deduct the taxes on his own. Approaching the tax officer for an order u/s. 195(2) is not required in every case.

This seems to be the department's stand too, which has in the FAQs prepared for QFIs mentioned at number 22 that the payer need not

46 CIT (International Taxation) vs. Samsung Electronics Co. Ltd. [2009] 185 Taxman 313
47 Transmission Corpn. of A.P. Ltd. vs. CIT [1999] 239 ITR 587
48 GE India Technology Cen. (P.) Ltd. vs. CIT [2010] 193 TAXMAN 234 (SC)
49 Syed Aslam Hashmi vs. ITO [2013] 55 SOT 441
50 R. Prakash vs. ITO [2013] 38 taxmann.com 123 (Bangalore - Trib.)

approach the tax department in every case of deduction of tax under Section 195.

The Supreme Court in GE India Technology Cen. (P.) Ltd. also held that *"….where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof."*

There are concerns whether a Chartered Accountant (CA) can issue certificate in cases of capital gains, especially where sale of properties are concerned. As an extension of the above principle, a CA can also issue a certificate in Form 15CB determining the amount of tax deducted at source. There is no bar on issuance of such certificates by CAs. However, as a practice, and to avoid unnecessary risk of incorrect computation of tax payable, deductors tend to approach the income-tax department for a certificate in such cases.

12.3 Applicability of Tax Residency Certificate and Section 206AA

Before finalising the deductibility of tax at source from capital gains, a deductor must take care of the provisions of Tax Residency Certificate and Section 206AA:

12.3.1 Tax Residency Certificate

It should be noted that, with effect from 1st April 2013, as per Sections 90(4) & 90(5), in case a tax payer wants to take benefit of a DTAA, it must obtain a Tax Residency Certificate (TRC) of the country of which it is resident for tax purposes. The TRC is required to be obtained at the time of availing the benefit of the DTAA. Further, it needs to contain the prescribed particulars, failing which the details need to be submitted under a self-declaration in Form 10F. In case no benefit of the DTAA is adopted, a TRC is not required.

12.3.2 Section 206AA

Section 206AA provides for deduction of tax at source at higher rates in case Permanent Account Number (PAN) is not available. In case a non-resident earning income from India does not provide a valid PAN, the tax rate applicable would the rates as per the Act, the DTAA or 20%, whichever is higher.

This provision is a non-obstante provision, superseding all other provisions under the Act. Therefore, even if tax is required to be deducted at a lower rate under any of the beneficial provisions of a DTAA, it may be deducted at a rate of 20% in case he does not obtain a PAN. However, it should be noted that a non-resident whose income is not taxable in India would not be covered by these provisions.

13. Closing note

In conclusion, taxation of capital gains for non-residents can raise tricky issues. However, the lower rates of tax now applicable (especially for long-term capital gains) has resulted in many special provisions to be largely ineffective in providing any further tax benefit.

Indirect transfer provisions recently introduced can lead to unintended taxation. However, clarity may come only after the provisions are suitably explained or amended. Existence of a DTAA can help mitigate the double taxation.

With GAAR coming into effect from 1st April, 2015, investment through offshore centres may not give any tax benefit.

There's nothing more important than our good health – that's our principal capital asset.

— *Arlen Specter*

Nikhil Ranjan, *Advocate*

Business Restructuring – Select Issues

This essay deals with select issues in relation to slump sale, and Ss. 47(iv)/(v)/(xiii)/(xiiib) & (xiv).

Sale vs. Other Modes of Transfer

S. 2(42C) of the Income-tax Act, 1961 ("the Act") defines "'slump sale' to mean the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales". A question arises whether slump transfer by way of sale is only covered in slump sale or does it cover transfer by any other mode.

As per S. 54 of the Transfer of Property Act, 1882, "'sale' is a transfer of ownership in exchange for a price paid or promised or part-paid and part-promised". S. 4 of the Sale of Goods Act, 1930 provides that "a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price." Clause (10) of s. 2 of the Sale of Goods Act defines "'price' to mean the money consideration for a sale of goods."

In *Bharat Bijilee Ltd. vs. ACIT 54 SOT 571 (Mum.),* the Tribunal held that the transfer of the undertaking by the assessee pursuant to a scheme of arrangement approved by High Court cannot said to be a sale of undertaking by the assessee. The lift division was transferred in exchange for issue of preference shares and bonds. The scheme did not mention the monetary consideration for the transfer. A mere quantification of bonds or preference shares when issued would not mean that the monetary consideration was determined. The parties were *ad idem* that under the scheme the assessee was to transfer the undertaking and take bonds or preference shares as consideration. Thus it was a case of exchange and not sale. S. 2(42C) did not apply to the case. Therefore, the provisions of s. 50B were held not applicable.

Slump sale, therefore, would not cover a transfer by way of exchange or one involving non-monetary consideration.

Negative net worth

According to S. 50B, any profits or gains arising from the slump sale effected in the previous year is chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and is deemed to be the income of the previous year in which the transfer took place. Where the industrial undertaking, transferred under slump sale, was owned and held by the assessee for not more than 36 months immediately preceding the date of its transfer, the profit or gains arising from such transfer is deemed to be capital gain arising from the transfer of short-term capital assets.

In case of a slump sale, the "net worth" of the undertaking or the division is deemed to be the cost of acquisition and the cost of improvement for the purposes of ss. 48 and 49 and no indexation benefit u/s. 48 is available.

Explanation 1 to s. 50B provides that "for the purposes of this section, ''net worth'' shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account".

In *Zuari Industries Ltd. vs. ACIT 105 ITD 569 (Mum.),* the assessee sold its cement division for a lump sum consideration. As the liabilities were more than the assets, the net worth was a negative figure. The Assessing Officer added the net worth to the sale consideration. Capital gain was computed on this figure which was higher than the sale consideration. The Tribunal held that in case of slump sale, where liabilities are more than value of assets, the net worth has to be taken at Nil. There is no concept of negative 'net worth' or 'cost of acquisition'. In *Paperbase Co. Ltd. vs. CIT 19 SOT 163 (Del.)*, the Delhi Tribunal followed the decision of the Mumbai Tribunal.

However, in *Dy. CIT vs. Summit Securities Ltd. 135 ITD 99 (SB),* the Special Bench of the Tribunal reversed the decisions in Zuari Industries and Paperbase Co. (supra). In Summit Securities, the assessee transferred its power transmission business to KEC for a total consideration of ` 143 crores pursuant to a scheme of arrangement u/ss. 391 & 394 of the Companies Act, 1956. The assessee claimed that the transaction was a "slump sale" u/s. 50B. As the net worth of the undertaking was a negative figure of ` 157.19 crores (being excess of liabilities over assets), the assessee treated the net worth as Nil and offered the entire sale consideration of ` 143 crore as long-term capital gain. The Assessing Officer added the liabilities of ` 157.19 crores taken over by the purchaser to the consideration of ` 143 crores and arrived at the full value of consideration of ` 300 crores. The CIT(A), relied on Zuari Industries and Paperbase Co. (supra) to hold that the 'net worth' in s. 50B could not be a negative figure and if it was so because of the liabilities exceeding the assets, the net worth had to taken at Nil.

The matter was referred to the Special Bench to consider two issues:

(i) Whether the excess of liabilities over assets could be treated as "consideration" in the hands of the assessee?

(ii) Whether the resultant "negative net worth" could be treated as Nil or had to be added to the "consideration"?

On the issue of the "full value of consideration", the Special Bench held that in the case of a slump sale, one lump sum value of the undertaking is arrived at by adding all assets and reducing all the liabilities, which is the "full value of the consideration". If one adds the liabilities to this value, one is arriving at the consideration for the "assets" but not the consideration for the "undertaking". Once the sale consideration has been approved by the High Court, it is unrealistic for the Revenue to contend that the consideration of ` 143 crores does not represent the full value of consideration of the undertaking.

On the issue of "negative net worth" the Special Bench held that the assessee's argument that if the net worth is negative, it should be taken at Nil is not acceptable. Though, in ordinary parlance, the terms "cost" and "net worth" may not have a negative value, in the context of s. 50B, if the liabilities exceed the assets, there would be a negative net worth. The said negative net worth has to be "deducted from" ("added to") the full value of consideration. Consequently, the chargeable capital gain is ` 300 crores i.e. ` 143 crores + ` 157 crores.

Therefore, as the law stands today, the amount of liabilities reflected in the negative net worth of the assessee's business undertaking cannot be added to the sale consideration for determining the capital gains on slump sale thereof. However, the negative figure of the net worth shall be considered for working out the capital gains. If the value of liabilities is more than the aggregate value of all assets, 'net worth' would be a negative figure and not zero.

Succession of sole proprietary concern by a company

As per clause (xiv) of s. 47, where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company, the same shall not be liable to capital gains tax provided that certain conditions are satisfied.

A question arises whether the exemption u/s. 47(xiv) applies only to an individual assessee who is a proprietor of the business or even to other categories of assessee being a proprietor of the business?

As per P. Ramanatha Aiyar's Advanced Law Lexicon, 4th Edn., 'Sole proprietor' is 'an alternative term for 'Sole trader'; 'Sole proprietorship' is defined as 'unincorporated business that is run by one person on his or her own. The sole proprietor of a professional practice (such as an accountant or solicitor) is known as sole practitioner. The sole proprietor of another type of business is generally known as a sole trader. Non-company business owned by one person (i.e., not limited for liability).'

If a business is not carried by an individual on his or her own, then it would most probably be business of a Hindu Undivided Family, a company, a firm or an association of persons, etc. In which event, it would certainly not be a business carried by an individual on his or her own. However, a joint family business is characterised by unity of ownership and community of interest, and the shares of members are not defined *[Nanchand Gangaram Shetji vs. Mallappa Mahalingappa Sadalge AIR 1976 SC 835].* In view of this a joint family business is more akin to a sole proprietary business.

Applicability of S. 47(xiii)/(xiv) to firm or sole proprietor carrying on profession

As per clause (xiii) of S. 47, any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an AOP or BOI is succeeded by such company, shall not be liable to capital gains tax on satisfying certain conditions. Similarly, where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company, the same shall not be liable to capital gains tax provided that certain conditions are satisfied (Clause (xiv) of S. 47).

One may ask whether the benefits of clauses (xiii) and (xiv) are available to any transfer of capital asset where the firm or the sole proprietorship, as the case may be, has been carrying on a profession.

"Business" is defined in S. 2(13) to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. According to clause (36) thereof "profession" includes vocation.

In re, Lala Indra Sen 8 ITR 187 (All.), the High Court held that the word "business" has been used in the Act to denote the continuous

and systematic exercise of an occupation or profession with the object of making income or profit, and where the element of continuity is wanting in a particular activity that activity cannot be characterised as "business" within the meaning of the Act. "Profession" or "occupation" can amount to business only if it is continuously and systematically exercised. ... A 'profession' involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities. The word "profession" is of wider import than the word "business" and the word "vocation" is of wider import than the word "profession" and lastly "occupation" is a word of wider signification than the word "vocation". In other words, what may not amount to business may amount to profession and what may not amount to profession may amount to vocation and what may not amount to vocation may amount to occupation within the meaning of the Act.

In view of the definitions of the expressions "business" and "profession" contained in the Act and the views taken by the Courts, business is a narrower and distinct from profession. However, in the facts and circumstances of a case, if a "profession" is exercised continuously and systematically with the object of making profit, it may be seen as a "business".

Strictly speaking a firm or a sole proprietorship carrying on a profession may not be able to avail the exemption under clauses (xiii) and (xiv) to S. 47. However, in particular facts and circumstances of a case, where a firm or sole proprietor carrying on "profession" is treated as one involved in doing "business", it may fall squarely within these provisions.

In *CIT vs. Texspin Engg. & Mfg. Works 263 ITR 345 (Bom.),* the High Court held that the conversion of a firm into company under Part-IX of the Companies Act, 1956 (Part-I of Chapter XXI of the Companies Act, 2013) would not attract s. 45(4) as there is neither any dissolution of a firm nor distribution of capital assets to the partners. S. 45(1) would not apply as the vesting of the properties of the firm in the company is not incidental to a transfer as contemplated by s. 45(1). S. 47(xiii) merely excludes certain transfers from the definition of "transfer" in s. 2(47) and would not affect any Part-IX type conversion of firms carrying any business or profession.

Exemptions u/s. 47(iv)/(v) vis-à-vis specific provisions in ss. 46A / 50B

The rule of harmonious construction says that when an enactment contains two conflicting provisions which cannot be reconciled, they should be interpreted in a manner as far as possible to give effect to both. One way of doing this is to find out which of the two provisions is more general and which is more specific and to construe the more general one as to exclude the more specific. In *J.K. Cotton Spinning & Weaving Mills vs. State of U.P. AIR 1961 SC 1170,* the Supreme Court held that in cases of conflict between a specific provision and a general provision the specific provision prevails over the general provision and the general provision applies only to such cases which are not covered by the specific provision.

S. 46A deals with the computation of capital gains in the hand of the shareholder or holder of other specified securities on receipt of consideration from the company for purchasing its own shares or other specified securities. Similarly, S. 50B sets out the special provision for computation of capital gains in case of slump sale of capital asset being one or more undertakings.

Ss. 46A and 50B are specific provisions dealing with computation of capital gains in the case of buyback and slump sale. This modifies the provisions of ss. 48 and 49 for the purpose. On the other hand, ss. 47(iv) and (v) exempts the transfer of capital asset between the holding company and its wholly-owned subsidiary.

In view of the above discussion, the special provisions of ss. 46A and 50B shall have applicability subject to the exemptions available to certain transactions between the holding and its wholly-owned subsidiary in S. 47.

Ss. 47(xiii)/(xiiib)/(xiv) vs. Ss. 47(iv)/(v) – Subsequent Violation – Cost to previous owner

Cost of acquisition of the capital asset in the hands of the asessee whose property it becomes by virtue of clauses (iv), (v) (xiii), (xiiib) or (xv) of s. 47, is deemed to be the cost for which the previous owner of the property acquired it plus the cost of any improvements of the assets incurred or borne by the previous owner or the assessee.

Where at any time before the expiry of a period of eight years from the date of the transfer of a capital asset referred to in clause (iv) or (v) of s. 47 is converted by the transferee company into, or is treated as, stock-in-trade of its business or the parent or the nominees or the holding company ceases or cease to hold the whole of share capital of the subsidiary company, the amount of profits or gains arising from the transfer of such capital asset not charged u/s. 45 by virtue of the provisions contained in clause (iv) or (v) of s. 47 is deemed to be income chargeable under the head capital gains of the previous year in which such transfer took place. In which event, the cost of acquisition of the asset to the transferee company is deemed to be cost for which the asset was acquired by it [s. 49(3)]

A violation of any conditions by virtue of which profits and gains arising from the transfer of a capital asset or intangible asset is not chargeable to tax under clauses (xiii), (xiv) or (xiiib) of section 47, such profits and gains shall be deemed to be the profits and gains chargeable to tax of the successor company or the successor limited liability partnership or the shareholder of the predecessor company, as the case may be, for the previous year in which the requirements of the said proviso are not complied with. In the event, the capital asset being rights of a partner became the property of the assessee on conversion as referred to in clause (xiiib) of section 47, the cost of acquisition of the asset to the transferee company is deemed to be cost of acquisition to him of the share or shares in the company immediately before its conversion [s. 49(2AAA)].

However, the Act is silent on the cost of acquisition to the successor company in the event of violation of provisions of clause (xiii) or (xiv) of s. 47. The question arises whether the cost of acquisition to the successor company shall be cost to the transferee company or the cost to the previous owner or Nil.

Good health and good sense are two of life's greatest blessings.

— *Publilius Syrus*

Jitendra Singh, *Advocate*

Shares and Securities

1. Capital gains on sale of Shares and securities

The present section 45(1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') corresponds to section 12B(1) of the 1922 Act.

Hon'ble Supreme Court in the case of *Navinchandra Mafatlal vs. CIT (1954) 26 ITR 758 (SC)* considered and upheld the constitutional validity of the amendments made by the Act XXII of 1947. The Supreme Court in that case held that the word 'income' in Entry 54 in List I of the Seventh Schedule to the Government of India Act, 1935, should be given its widest connotation so as to include the capital gain.

Under the existing provisions of section 45 profits or gains arising from the transfer of a capital asset effected in the previous year are taken to be the income of the previous year in which the transfer took place and are chargeable to income-tax under the head "Capital Gains". Section 45(1) provides for levy of tax on capital gains, if following conditions are satisfied:

(i) The assessee must own the capital asset;

(ii) Capital asset must be transferred during the previous year;

(iii) There should be profits or gains on account of transfer of capital asset.

Capital Asset is defined in section 2(14) of the Act. It has also excluded certain kind of properties from the definition of capital asset. Section 2(14) of the Act specifically excluded stock-in-trade from being considered as capital asset. The Phrase Stock-in-Trade has not been defined in the act. However, the generally understood meaning of the words "stock-in-trade" is "all those goods or commodities in which the particular individual deals in the sense of buying and selling in the course of his business activity and it cannot be said to include a commodity which is acquired for the purpose of being let to hire".

The term share has not been defined in the Act. The term share has been included in section 2(7) of the Sale of Goods Act, 1930 as "Goods" means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. Thus, the term share can be understood as a movable property which can be bought and sold. The Oxford dictionary conveys the meaning of the term share as 'one of the many equal parts into which the value of a company is divided, that can be sold to people who want to own party of the company'.

Section 2(4) of Securities Contracts, (Regulation) Act, 1956 defines 'securities' to include

i) shares, scripts, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

  (ia) derivative;

  (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;)

  (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;)

  (id) units or any other such instrument issued to the investors under any mutual fund scheme;)

  (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;)

(ii) Government securities;

  (iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interest in securities;

An Individual makes investment in shares for earning long-term benefits such as dividend income. In such case the shares are treated as a capital asset of the Individual holding such shares. Section 2(14) of the Act defines the term capital assets as property of any kind held by an assessee, whether or not connected with his business or profession, but does not include stock-in-trade. On transfer of such capital asset the long/short-term capital gains/loss are chargeable to tax depending upon the period of holding of such shares.

Section 2(29A) of the Act defines the terms long term capital assets which are not short term capital assets. The short-term capital asset is defined under section 2(42A) of the Act to mean a capital asset held by an assessee for not more than thirty Six months immediately preceding the date of its transfer.

Hon'ble Karnataka High Court in the case of *National Product vs. CIT (1987) 163 ITR 632 (Karn)* held that the words 'the transfer of a capital asset' occurring in section 45 cannot be interpreted as a transfer of the entire capital asset and not a part of the same. The words 'a capital asset' may mean the whole of that capital asset when so transferred or a part of that capital asset also. Similar view has been taken by the Hon'ble Gujarat High Court in the case of *Dilip Chinubhai Shah vs. CIT (2002) 253 ITR 680 (Guj).*

2. Distinction between shares held as stock-in-trade and shares held as investment – Tests for such a distinction

The Income Tax Act, 1961 makes a distinction between a capital asset and a trading asset.

Capital asset is defined in section 2(14) of the Act. Long Term Capital Assets and gains are dealt with under section 2(29A) and section 2(29B). Short-term capital assets and gains are dealt with under section 2(42A) and section 2(42B). Trading asset is dealt with under section 28 of the Act.

The Central Board of Direct Taxes (CBDT) way back through Instruction No. 1827 dated August 31, 1989 had brought to the notice of the Assessing Officers that there is a distinction between shares held as investment (capital asset) and shares held as stock-in-trade (trading asset). The circular issued by the CBDT serves as guiding principles for the department as well to the assessee's for finding out whether the transactions in shares is investment or made with the purpose of profit motive i.e. to be considered as business income.

In the case of *CIT vs. Associatied Industrial Development Company (P) Ltd (1971) 82 ITR 586,* the Supreme Court observed that:

"Weather a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and he should, in normal circumstances, be in a position to produce evidence from his records as to whether he has maintained any distinction between those shares which are his stock-in-trade and those which are held by way of investment."

In the case of *CIT vs. H. Holk Larsen (1986) 160 ITR 67,* the Supreme Court observed (page 87):

"The High Court, in our opinion, made a mistake in observing whether transaction of sale and purchase of shares were trading transactions or whether these were in the nature of investment was question of law. This is a mixed question of law and fact."

The principles laid down by the Supreme Court in the above two cases afford adequate guidance to the Assessing Officers. The CBDT considering the above two decisions of the Hon'ble apex court issued Circular No. 4/2007 dated 15-6-2007 (2009) 291 ITR (St.) 384 providing guiding factors to the Assessing Officer to treat the shares as investment or stock-in-trade.

3. Some judicial pronouncement on whether the transaction in shares is investment or stock-in-trade

A. Claim accepted in earlier year accepted by department-principles of consistency

(i) *Gopal Purohit vs. JCIT [2009] 122 TTJ 87 (Mum.)*

In this case Hon'ble Mumbai Appellate Tribunal has held that the nature of activities, modus operandi of the assessee, manner of keeping records and presentation of shares as investment at the year-end were same in all the years, and, hence, apparently, there appeared no reason as to why the claims made by the assessee should not be accepted. However, the revenue authorities had taken a different view in the year under consideration by holding that principle of res judicata was not applicable to the assessment proceedings. There could not be any dispute on this aspect, but there is also another judicial thought that there should be uniformity in treatment and consistency under the same facts and circumstances and it was already found that facts and circumstances were identical, even though a different stand had been taken by the revenue authorities

Hon'ble Bombay High Court has affirmed the view taken by the Appellate Tribunal in *CIT vs. Gopal Purohit (2011) 336 ITR 287 (Bom.)*

Department's SLP is also dismissed by *Hon'ble Apex Court as reported in (2011) 334 ITR 308 (St.)*

ii) *SMK Shares & Stock Broking Pvt. Ltd. (2010) 8 taxmann.com 120 (Mum).*

The uniformity in treatment and consistency under the same facts and circumstances is one of the fundamentals of the judicial principles which cannot be brushed aside. Assessing officer himself

accepted the assessee as investor in earlier years. All these factors outweigh the test of frequency of transaction being undertaken by the assessee in deciding the true intention of assessee.

iii) *Bharat Kunverji Kenia vs. ACIT (2010) 130 TTJ (Mumbai)(UO)86.*

Principle of consistency in holding the shares as investment which is always accepted by Department in past. The position cannot be allowed to change, merely because on same set of facts a different view is possible.

B. Holding period of shares

Though the holding period of shares do not conclusively determine whether the transaction in share is investment or business activity, various courts have held that holding period of shares do gives an indication of whether the transaction is for investment or for earning profit motive. Further the courts have also held that if the same type of activity is accepted by the department in the earlier year as investment, the same will not change in the subsequent years. Some important case laws on the subject is as under:

i) *Gold Co. Ltd. vs. CIT (1973) 92 ITR 121 (Cal.) (HC)*

The length of time, nature of dealings, method of dealings, how proceeds of sale are dealt with by assessee, these ingredients and other factors are some of matter that would determine question whether a particular transaction is in realization of investment or a sale in ordinary course of business.

ii) *CIT vs. S. Ramaamirtham (2008) 306 ITR 239 (Mad.)*

The assessee had been holding shares for a long time and had been utilising the surplus funds only for the investments. In earlier years also, the assessee had been showing only capital gains on similar transactions and that was accepted by the Revenue.

iii) *Hardik Bharat Patel vs. DCIT, ITA Nos. 2274 & 8013/Mum/2011 dated 1-5-2013.*

In this case the Appellate Tribunal observed that the department itself has accepted the short term capital gain shown by the assessee while passing assessment under Section 143(3) for assessment year 2006-07 and for assessment year 2009-10. Both these assessments were completed under Section 143(3) and similar transactions were made and they were accepted. Different yardstick adopted for these two years under consideration, which was not justified. The assessee is a salaried person and shown all the purchases of shares under the head investment portfolio, therefore, they have to be treated under the head investment portfolio and capital gain whether short term or long term capital gain has to be assessed.

Off late, the Tribunals have been taking a view that shares held for a period of less than 30 days are business assets while those held for 30 days or more are investments. This view does not find a place on the statute books, but to settle disputes of this kind, the Tribunals have evolved this principle, wherever appropriate having regard to the facts and circumstances of the case.

i) *Hitesh Satishchandra Doshi vs. Jt. CIT (2011) 46 SOT 336 (Mum.)*

The Tribunal has observed that there is no indication of holding period of 30 days finds place either in the statute or in the circular/instructions as well as judicial pronouncements held that the ld. CIT(A) was not justified in treating the share transaction as business transactions in the case where the holding period is less than 30 days and further held that the income arisen from purchase and sale of shares

held by the assessee is investment, cannot be treated as business income.

ii) *Dev Ashok Karvat vs. DCIT (2012) 50 SOT 167 (Mumbai)*

The Mumbai Appellate Tribunal has followed the above decision of Hitesh Satishchandra Doshi (Supra) and allowed the appeal of the assessee.

iii) *Sugamchand C. Shah vs. ACIT (2011) 139 TTJ 610 (Ahd.)(Trib.)*

The Ahmedabad Appellate Tribunal in this case has held that shares kept for more than a month would be treated as investment and on their sale short-term capital gain would arise whereas gain arising on sales held for less than a month would be treated as profit from business

C. Two separate portfolios

Time and again various courts and tribunals have affirmed that it is possible for an assessee to maintain two separate portfolios i.e. one for investment and another for stock-in-trade. Some important judicial pronouncement on this

i) *CIT vs. Suresh R. Shah (2013) 256 CTR 104 (Mad.) (HC)*

It is open for the Assessee to maintain two separate portfolios one for investment and other for maintaining business activities of shares.

ii) *CIT vs. Avinash Jain (2013) 214 Taxman 260 (Delhi)*

Where assessee engaged in purchase and sale of shares, maintained two separate portfolios i.e. an investment portfolio and a trading portfolio, income arising from sale of shares out of investment account was to be treated as 'capital gain' and not 'business income' of assessee.

iii) *Dy. CIT vs. Emerging Securities (P.) Ltd [2013] 39 taxmann.com 169 (Delhi – Trib.)*

Where most of shares were from brought forward holding from preceding years which had been accepted as investment in earlier years and further assessee was maintaining separate account for investment as well as stock in trade of shares, sale proceeds of such shares were to be treated as capital gains and not business income.

D. Intention of the assessee:

i) *CIT vs. Trishul investments Ltd [2008] 305 ITR 434 (MAD.).* In this case Hon'ble Madras High Court has held as under:

The finding given by the Tribunal was that the assessee had no intention to trade in shares. The assessee-company's main business was investment in shares and securities and it was never in business of trading in shares, shares could not be treated as business assets but income from sale of shares was liable to capital gains.

The Hon'ble apex court has dismissed the SLP filed by the department on 11-7-2008 in SLP (CC) No. 8665 of 2008.

ii) *Khan Bahadur Ahmed Allauddin & Co. vs. CIT (1966) 62 ITR 490 (AP)*

Where shares were acquired merely with intention of obtaining a managing agency and not of dealing in shares and shares were sold at loss to another company under same management, the loss was held to be not a trading loss.

iii) *Dalhousie Investment Trust Co. Ltd. vs. CIT (1967) 66 ITR 473 (SC))*

Mere fact that an investment company periodically varies its investments does not necessarily mean that the profits resulting therefrom are trading profits.

iv) *Gondhara Transport Co. (P.) Ltd. vs. CIT (1972) 84 ITR 294 (P&H)*

Where assessee-transporter suffered loss on sale of shares of another transport company, which it had purchased to eliminate competition, such loss was held to be capital loss.

v) *Janak S. Rangwala vs. ACIT (2007) 11 SOT 627 (Mum.) (Trib.)*

It is the intention of the assessee which is to be seen to determine the nature of transaction conducted by the assessee. Though the investment in shares is on a large magnitude but the same shall not decide the nature of transaction. Similar transactions of sale and purchase of shares in the preceding years have been held to be income from capital gains both on long-term and short-term basis.

vi) *Vinod K. Nevatia vs. ACIT (2011) 49 DTR 16 (Mum.)(Trib.)*

Primarily, it is the intention with which an assessee starts its activity which is the most important factor which has to be considered keeping in view the adjoining circumstances. Mere intention to liquidate the investment at higher value does not imply that the intention was only to trade in security.

vii) *Accra Investments (P) Ltd vs. ITO (2013) 93 DTR 89 (Bom.)*

Assessee, engaged in the business of investment, subscribed to 20% of the issued shares of a company with a right to nominate manager of the investee company. The shares were not freely transferrable. Held, on facts, that the profit on sale of these shares was capital gains.

viii) *Management Structure & Systems vs. ITO ITA No. 6966/Mum/2007 dated 30-4-2010*

The intention of the assessee cannot be read from his mind but it reflects in his conduct and the way he treats the transactions. Considering the totality of the facts, the transactions of sale and purchase of shares cannot be treated to be trading in shares nor as an adventure in the nature of the trade but is assessable as 'capital gain'.

D. Volume and number of transactions; quantum of investments:

It is true that volume of transaction is an important indicator of intention of assessee whether to deal in shares as trading asset or to hold same as investment but certainly not the sole criterion. The Circular No. 4/2007 dated 15-6-2007 issued by CBDT makes it amply clear that frequency, volume, and Value of transactions cannot be the only criteria for determining the nature activities carried on by the assessee. This Circular affirms the guidelines issued by the CBDT IN the earlier Instruction no. 1827 dated August 31, 1989. Some decision on this point is as under:

i) *Suresh Kumar Seksaria vs. ACIT (2010) 1 ITR 783 (Mum.) (Trib.)*

The volume and number of transactions is not decisive in understanding the true nature of the transactions. The volume and number will depend upon the quantum of investments being made. If funds invested are huge, obviously the number of transactions and volume will become high.

ii) *Shantilal M. Jain vs. Asst. CIT (2011) 132 ITD 466 (Mum.)(Trib.)*

In this case assessee had traded in 85 scripts in 188 transactions with high frequency and regularity. Despite large volume etc. of share transactions, AO bound by Rule of Consistency to treat share gains as STCG. Though it is the case of the revenue that due to volume, magnitude, frequency, continuity, regularity, the ratio between purchase

and sale clearly indicate that income on account of purchase and sale of shares should be treated as income from business and not as income from STCG, the AO has, from AY 2005-06 to 2009-10 (except for the impugned year & 2006-07), consistently accepted the income as being STCG. In these circumstances, the Rule of consistency as propounded by the Bombay High Court in Gopal Purohit is squarely applicable and the income has to be treated as STCG.

iii) *Nehal vs. Shah vs. ACIT ITA No. 2733/Mum/2009, dated 15-12-2010*

In this case the Appellate Tribunal has held that multiple orders for purchase/sale of shares may constitute one transaction. The Appellate Tribunal has also explained the same by way of example as sometimes a single transaction is split by the computers trading of the stock exchanges into many smaller transactions but that does not mean that assessee has carried so many transactions. If someone places an order for purchase of 1000 shares and the same is executed by the electronic trading system of stock exchange into 100 smaller transactions, it does not mean that 100 transactions have been entered into.

E. Borrowed funds: Use of borrowed funds

The use of borrowed funds for the purpose of buying and selling shares has often been considered by Courts as an indication as to the share transaction activity is in the nature of investment or business.

i) *CIT vs. Niraj Amidhar Surti (2012) 347 ITR 149 (Guj.)*

Merely because the shares had been purchased from borrowed funds obtained on high rate of interest would not change the nature of the transaction from investment to one in the nature of an adventure in the nature of trade.

ii) *CIT vs. S. Ramaamirtham (2008) 306 ITR 239 (Mad.)*

The assessee had been holding shares for a long time and had been utilising the surplus funds only for the investments. In earlier years also, the assessee had been showing only capital gains on similar transactions and that was accepted by the Revenue.

iii) *Spectra Shares & Scripts Pvt. Ltd. vs. CIT (2013) 91 DTR 289 (AP).*

Assessee a non-banking finance company, made all investments with its own fund earned substantial dividend valued closing stock at cost it was held that Assessing officer was right in treating the sale of share under head Capital Gain. Commissioner's action in revising such an order held bad in law.

iv) *Mahendra C Shah vs. ACIT (2011) 140 TTJ 16 (Mumbai)*

S. Balan alias Shanmugam Balkrishnan Chettiar vs. Dy. CIT (2009) 120 ITD 469 (Pune).

There can be no thumb rule that a person cannot borrow monies for the purpose of making investments. The gain on sale of shares has to be treated as capital gains and business income.

F. Frequency of transactions

i) *ITO vs. Rohit Anand (2010) 127 TTJ 122 (Delhi)*

The volume of transaction includes the appreciation in shares also and such appreciation has been offered for tax. If volume of transaction is the criteria, what is to be examined is how frequently

the transaction is done, whether the transaction is settled in the course of the day of trading itself or in the settlement period itself so as to avoid payment of full purchase price.

ii) *Ramesh Babu Rao vs. DCIT ITA No.3719/Mum/2009 order dated 13-4-2011*

The Appellate Tribunal has observed that the large turnover was because of bulk purchases and sales in a scrip. There were very few transactions of purchase and sale, as the assessee was purchasing in block of a particular share in large volume. Accordingly, large volume cannot be a deciding factor to hold as a trader.

iii) *CIT vs. Neo Poly Pack (P) Ltd. (2000) 245 ITR 492 (Del.)*

The mere magnitude of transaction does not change the nature of transaction, which are being assessed as income from Capital Gains in the past several years.

iv) ACIT vs. Naishadh V. Vachharajani in ITA 6429/Mum/2009 dated 25-2-2011

The Mumbai Appellate Tribunal has followed the decision of the Hon'ble Delhi High Court *CIT vs. Neo Poly Pack (P) Ltd. (supra)* and dismissed the appeal of the department.

Hon'ble Bombay High Court affirmed the above view taken by the ITAT in *CIT vs. Naishadh V. Vachharajani in ITXAL No. 1042 of 2011 dated 22-9-2011.*

4. Whether conversion of preference shares into equity shares results into taxable capital gains?

As the name suggests the holder of preference shares are having priority in payments over the other shareholders. Thus, preference share means a share which entitles the holder to a fixed dividend, whose payment takes priority over that of ordinary share dividend. The Investopedia.com defines the word 'preference shares' as company stock with dividends that are paid to shareholders before common stock dividends are paid out. In the event of a company bankruptcy, preferred stock shareholders have a right to be paid company assets first. Preference shares typically pay a fixed dividend, whereas common stocks do not. And unlike common shareholders, preference share shareholders usually do not have voting rights.

Equity Shares are any shares that are not preferred shares and do not have any predetermined dividend amounts. It is also called as 'Ordinary Shares'. An ordinary share represents equity ownership in a company and entitles the owner to a vote in matters put before shareholders in proportion to their percentage ownership in the company.

Ordinary shareholders are entitled to receive dividends if any are available after dividends on preferred shares are paid. They are also entitled to their share of the residual economic value of the company should the business unwind; however, they are last in line after bondholders and preferred shareholders for receiving business proceeds. As such, ordinary shareholders are considered unsecured creditors.

Section 2(47) of the Act defines transfer in relation to capital asset, includes the sale, exchange or relinquishment of the asset. Thus, conversion of preference shares into equity shares amounts to transfer under exchange. Hon'ble Andhra Pradesh High Court in the case of *Addl. CIT vs. Trustees of H.E.H. Nizam's Second Supplementary Family Trust (1976) 102 ITR 248 (AP)* held that the conversion of preference shares into ordinary shares is a transfer by way of "exchange" and hence, the capital gains/loss arising on such conversion were liable to be taxed within the meaning of section 45 of the Act. The Hon'ble Andhra Pradesh High Court while coming to the above conclusion

followed the reasoning of the Supreme Court in understanding the word "exchange" in *CIT vs. Motors and General Stores (P) Ltd. (1967) 66 ITR 692 (SC).*

Hon'ble Bombay High Court in the case of *CIT vs. Santosh L. Chowgule (1998) 234 ITR 787 (Bom)* followed the above decision of Hon'ble Andhra Pradesh High Court and held that, where the original equity shares were exchanged in a scheme or re-organisation for a new type of equity shares and irredeemable preference shares, it was held that the loss occasioned on such conversion with reference to the market value of the substituted asset has to be allowed as capital loss.

Hon'ble Supreme Court in the case of *Kartikeya V. Sarabhai vs. CIT (1997) 228 ITR 163 (SC)* held that the reduction of the right in the capital asset would clearly amount to a transfer within the meaning of the expression in section 2(47) and the same is exigible to capital gain tax.

5. Global Depository Receipts (GDRs)

Indian companies are permitted to issue its Rupee denominated shares to persons outside India for the purpose of issuing Global Depository Receipts (GDRs). GDRs are negotiable certificates issued by depositary banks which represent ownership of a given number of a company's shares which can be listed and traded independently from the underlying shares. GDR's facilitates purchase, holding and sale of foreign securities by global investors. GDRs are issued by the overseas depository bank (ODB) while the underlying shares remain in fiduciary ownership of ODB, whereas such shares are physically held by the Domestic Custodian Bank.

Taxability of GDR

The taxability of income from GDRs is governed by Section 115AC of the I-T Act.

When a GDR is sold in a foreign stock exchange or at any place outside India in a transaction between two non-residents, there is no liability to capital gains tax in India.

If any capital gains arise on the transfer of the aforesaid shares in India to the non-resident investor, he is liable to income tax under the provisions of the Income Tax Act, 1961. If the aforesaid shares are held by the non-resident investor for a period of more than twelve (12) months from the date of advice of their redemption by the Overseas Depositary Bank, the capital gains arising on the sale thereof are treated as long-term capital gains and are currently not subject to any income tax under the provisions of Section 115AC of the Income Tax Act, 1961. If such shares are held for a period of less than twelve (12) months from the date of redemption advice, the capital gains arising on the sale thereof are treated as short-term capital gains.

6. Indian Depository Receipts

Indian Depository Receipts (hereinafter "IDRs") means any instrument in the form of a depository receipt created by the domestic depository in India against the underlying equity shares of the issuing company. This has been stipulated in the Companies (Issue of Indian Depository Receipts) Rules, 2004. IDRs are basically financial instruments that allow foreign companies to mobilise funds from Indian markets by offering equity and getting listed on Indian stock exchanges. This instrument is similar to the GDRs and ADRs that allow foreign companies to raise funds from European and American markets, respectively.

Although, the clause relating to IDR issue in the Companies Act (Amendment) Bill, 1997 had a provision stating that the Government would make rules for taxing gains on sale of IDRs, Section 605A introduced in the Companies Act does not contain this requirement. In the absence of any specific provision in the Income-

Tax Act, 1961 (hereinafter "IT Act") for taxing the gain on sale of IDRs, the general rules relating to capital gains taxation continue to apply. It may be noted that the income by way of capital gains may be subject to a higher rate of tax.

The IDRs are not exempted from long-term capital gains unlike shares, and are taxed at the regular long-term capital gains rates, with cost indexation benefits. Short-term capital gains tax at the rate of 15 per cent applicable for investments in securities will not apply for IDRs instead taxation will be done according to tax slab rates. Since IDRs are not considered to be securities, Securities Transaction Tax shall not have to be paid. However, similar to that of securities, holding an IDR for more than 12 months will qualify it as a long-term investment. The issuing company will not pay dividend distribution tax, as is being paid by Indian companies which allows the dividend to be tax-free for the investors. Dividends on IDRs received will be taken as taxable income in the hands of the investors.

7. Taxability of Bonus shares

Bonus shares are issued by the company to its existing shareholders in proportion to the shares that they hold. The cost of bonus shares will be exactly the amount that is paid for acquisition of original shares. As the bonus shares are issued by the company free of cost, it has no cost of acquisition.

The Finance Bill, 1995 published in (1195) 212 ITR 357 (statute) provides for the procedure for computation of capital gains on transfer of bonus shares, as under:

"Simplified procedure for computation of capital gains on transfer of bonus shares".

Bonus shares are received by an existing shareholder without making any further payment. At present, cost of acquisition of these shares is taken on the basis of principles laid down by the Supreme Court in the case of *CIT vs. Dalmia Investment Company Ltd. (1964) 52 ITR 567*. It has been held that the cost of a bonus share is to be determined by averaging the cost of the original shares and bonus shares.

Computation of the cost of bonus shares on the principle of averaging, however, is not a simple job and has led to a number of difficulties. For the sake of clarity and simplicity, section 55 is being amended to provide that the cost of bonus shares will be taken as nil for computation of capital gain on sale of bonus shares. This would not affect the cost of original shares. This procedure will also be applicable to any other security where a bonus issue has been made.

The period of holding of the bonus asset will be reckoned from the date of allotment of such asset.

Thus, the holding period of the bonus shares starts from the time that they were allotted. Further, the cost of bonus shares will be taken as nil for computation of capital gains on sale of bonus shares. This has nothing to do with the holding period of the original shares. If the bonus shares are held for a period more than a year then the gains would be long term capital gains and if they are sold on the stock exchange then there would not be any tax to be paid. If the shares are sold before a period of one year then the gains would be short term capital gains.

When Bonus Shares are issued to the equity shareholders, the value of the shares is not taxed as dividend distributed. However, where redeemable preference shares are issued as Bonus shares, on their redemption, the amount shall be taxed as dividend distributed.

Where Bonus Shares are issued to the Preference Shareholders, on their issue it is deemed to be dividend and liable to tax.

Mandar Vaidya, *Advocate*

Other Sections dealing with specific situations under Capital Gains

The Income-tax Act makes certain special provisions vis-a-vis capital gains (leviable u/s. 45 of the Act). In this article, endeavour is made to analyse the provisions under sections 46, 49, 50 and the exemption sections of the Act. These three sections provide for exemptions from capital gains arising out of transfer of a long term capital asset.

Section 50 – Assessment of capital gains where the asset has enjoyed depreciation

Section 50 of the Act provides (briefly) that where a capital asset forming part of a block of assets in respect of which depreciation has been allowed is transferred, the 'cost of acquisition' of such an asset shall be the aggregate of the following:

a) expenditure incurred wholly and exclusively in connection with such transfer(s)

b) written down value of such block of assets at the beginning of the previous year, and

c) actual cost of any asset falling within the block of assets acquired during the previous year (if any)

The difference between the full value of consideration and 'cost of acquisition' as computed in the above manner shall be deemed to be the capital gains arising from the transfer of short-term capital assets. The intention behind this provisions is that an assessee should not enjoy double benefits i.e. depreciation as well as indexation. The opening words of section 50 state that the above modification shall be for the purpose of sections 48 & 49. In other words section 50 only modifies the applicability of sections 48 & 49 and no other provisions and hence the applicability of section 50 is to be confined only to computation provisions viz. sections 48 & 49. So when an asset is assessed u/s. 50, the assessee is not eligible for claiming indexation. However, it is to be noted that the legal fiction created by section 50 is to deem the transaction of capital gain as a short-term capital gain transaction and not to deem an otherwise long-term capital asset as short-term capital asset *[CIT vs. ACE Builders 281 ITR 210 (Bom.)].* So the legal fiction of section 50 has no application to other sections; when an assessee transfers an asset for which depreciation has been allowed (and hence assessed u/s. 50) but the asset is a 'long-term' one within the meaning of section 2(42A) of the Act, the assessee is eligible for exemption u/s. 54F *[CIT vs. Rajiv Shukla 334 ITR 138 (Del.)]* and/or 54EC. Similarly the fiction of section 50 does not extend to section 74. So brought forward loss out of long-term capital asset can be set off against gains assessed u/s.

50 *[Manali Investments (2011) 139 TTJ (Mum.) 411: 56 DTR 218].*

However, section 50 has no application where depreciation has neither been claimed nor been allowed. D*ivine Construction Co. vs. ACIT 138 TTJ (Mum.) 72.* In this case depreciation was allowable on a particular asset but the same was neither claimed nor allowed. So the transaction of transfer was claimed by the assessee as 'Long-term' and indexation was claimed. The Revenue relied upon the 'Explanation' to section 32 and contended that depreciation should be deemed to have been allowed. The Hon'ble rejected this contention and held that in order that section 50 is attracted, depreciation should have actually been allowed. The objective behind section 50 is that where depreciation has been allowed on the particular asset, the same should not be eligible for indexation viz. an asset should not enjoy double benefit of depreciation as well as indexation. So where depreciation has not been allowed although the same was allowable, section 50 can have no application and on transfer of such an asset (which has not enjoyed depreciation), the transaction will be treated as 'Long-term' (and consequently indexation would be available). Conversely where no depreciation was allowable on a particular asset but nevertheless it has been allowed, section 50 gets triggered and transfer will be assessable u/s. 50.

One question that often arises is when an asset is forming part of the block but the asset has not been used for the purpose of the business for a long time due to closure of business or otherwise, then whether the asset can be said to have come out of the block and in such a situation whether the assessee would be eligible for indexation. This issue is no longer *res integra* and it is now settled that once as asset has formed part of the block and if the asset has enjoyed depreciation in the earlier years then the asset continues to remain in the block and on transfer the gain would be assessable u/s. 50. In such a case it cannot be said that on account of long period of non-use the asset comes out of the block. So even if depreciation is claimed one year the asset remains in the block. [See: *CIT vs. Sakhti Metal Depot 333 ITR 492 (Ker.)].* Same view of the Special Bench in case of *Chhabria Trust 87 ITD 181 (Mum.) (SB).*

Where land & the structure standing on it(i.e. the building are sold in a composite transaction, the capital gain has to be bifurcated into two parts. This is for the reason that depreciation is claimed only for building and not for land. SO gains out of building alone are assessable u/s. 50. In India, the law has always been that land and the structure standing on it, are separate properties – Hindustan Hotels 335 ITR 60 (Bom.). However, the Hon'ble Madras High Court took a different view. It held that once land forms part of the asset, section 50 can have no application since it is not possible to bifurcate the consideration into land and the building. – *Raka Food Products 277 ITR 261 (Mad.).*

Section 50 provides that cost of acquisition of the block of assets shall be written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year. The section does not say that cost of acquisition of the block of assets shall be taken on the date of transfer of the old machinery. Only requirement is that addition to the machinery must have been made during the previous year itself. – Eastman Industries 174 Taxman 344 (Del.)

Section 50C would apply to the depreciable assets covered u/s. 50. – *United Marine Academy {2011} 9 ITR (Trib.) 639 (Mum.) (SB).* This is because, section 50 only modifies the 'cost of acquisition' for the purpose of section 48 but does not impact the 'Full value of consideration' whereas section 50C specifically applies to 'Full Value of Consideration'. Hence both the sections can be given a harmonious construction.

Period of holding

The word 'property' is of widest amplitude and this is re-emphasised by the use of the words "of any kind". Right acquired under an 'Agreement to Sale' (by the assessee/transferee) is 'property' and capital gains would accrue on its transfer/relinquishment. Tata Services 122 ITR 594 (Bom.) – Right to get conveyance is a property and cost of acquisition is the cost of acquisition. This decision is an authority for the principle that on entering into an agreement in the nature of an 'Agreement to Sale', a right in the nature of property is acquired by the transfer. In other words, on the basis of the principle laid down, the period of holding should commence from the date of entering into agreement.

Where a property is bought on instalment basis, the period of holding is not to be calculated from the payment of last instalment but from the date of agreement. Section 2(42A) uses the word 'owner' which is not defined – it can mean a person who owns/possesses/holds/holds as a tenant, etc. So a person can be said to be owner as a lessee, as a mortgagee or on account of part performance also. Reference can be made to the decision of the *Hon'ble Punjab & Haryana High Court in Ved Prakash & Sons 207 ITR 148 (P&H),* in which the Hon'ble Court observed as follows: "The word "hold", as per dictionary meaning, means to possess, be the owner, holder or tenant of (property, stock, land ....). Thus, a person can be said to be holding the property as an owner, as a lessee, as a mortgagee or on account of part performance of an agreement, etc. Conversely, all such other persons who may be termed is lessees, mortgagees with possession or persons in possession as part performance of the contract would not in strict parlance come within the purview of "owner". In the case of Neville Pereira 45 SOT 111 (Mum.) (URO), the assessee paid instalments and got possession on 15-5-1986 and sold the flat on 6-1-1989. The transaction was held to be Long-term Capital Gain; it was held that the period of holding ought not to be computed from the date of possession but date of first instalment.

Family arrangement

A family arrangement does not amount to 'transfer' and hence not exigible to capital gain. The rationale is that the transferee already had a right/title/interest in the property and hence there is no question of any 'transfer'– *CIT vs. Sachin Ambulkar ITXA/6975 of 2010 (decided on 23rd October, 2012).*

Section 46 – Applicability & scope

Section 46(1) provides that when a company distributes its assets to its shareholders on its liquidation, such distribution will not be considered as transfer by the company and hence no capital gains will accrue in the hands of the company. Section 46(2) of the Act stipulates that when a shareholder receives money or any other asset from a company on its liquidation, such shareholder shall be charged to capital gains tax. This capital gain is on account of transfer of shares by way of extinguishment of rights in the shares. The section further provides that sales consideration for the purpose of computing capital gains will be money actually received or fair market value of the asset on the date of distribution, as the case may be. The said sales consideration will be as reduced by the amount assessed under s. 2(22)(c) . In view of the provisions of section 46(2), value of assets received by the assessee on the liquidation of a company towards the shares held by him in the company will be exigible to capital gains tax, excluding the amount assessed as dividend within the meaning of section 2(22)(c) – *Vijay Kumar Budhia vs. CIT [1993] 204 ITR 355 (SC).* A contributory receiving assets from a company not necessarily receives the assets of the value determined by the liquidator. Where such a value has been determined by the liquidator, it is the duty of the ITO and within his power to determine the market value of the assets received by the shareholder and such a market value has to be determined as prevalent on the date of distribution. – *CIT vs. Vijoy Kumar Budhia* (supra)*/Addl. CIT vs. Uma Devi Budhia [1986] 157 ITR 478 (Pat.).* This is because, section 46 uses the term 'market value of the other assets'.

CA Anand Shah & CA Rinkesh Devnani

Transactions in Stock Derivatives – Whether Speculative in Nature

Under the Income-tax Act, 1961 ('Act'), separate provisions exist in relation to set-off and carry forward of losses arising from speculation business. To give effect to these provisions, it is imperative that income and losses from speculation business is computed separately. Even otherwise, Explanation 2 to section 28 of the Act provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the said business shall be deemed to be distinct and separate from any other business.

The aforesaid provisions raise an important question – what constitutes a speculation business? The answer to this question lies under two different sections of the Act wherein a speculation business/transaction is defined as follows:

Section 43(5) – This section defines the term 'speculative transaction' as a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

Clauses (a) to (e) of the proviso to the aforesaid section carve out certain contracts which, even though settled otherwise than by actual delivery, are still not considered as speculative transactions. Clause (d) of the proviso, which is relevant for the purposes of present analysis, covers transactions in derivatives as defined in Securities Contracts (Regulation) Act, 1956 ('SCRA') which are executed on a recognised stock exchange.

Thus, transactions in derivatives (as defined in SCRA) executed on a recognised stock exchange, which even though are settled otherwise than by actual delivery of the underlying shares are not considered as speculative transactions.

Section 73 – As per Explanation to this section where any part of the business of a company consists of purchase and sale of shares, such company is deemed to be carrying on a speculation business to the extent the business consists of purchase and sale of shares. However, this section does not apply to a company:

- Whose gross total income mainly consists of income which is chargeable under the heads 'Interest on securities', 'Income from house property', 'Capital gains' and 'Income from other sources'; or
- Whose principal business is the business of banking or the granting of loans and advances.

While section 43(5) defines the term 'speculation transaction' as the one which is settled without taking or giving delivery (i.e., essentially cash settled), Explanation to section 73 creates

a deeming fiction in relation to business consisting of purchase and sale of shares (subject to satisfaction of other conditions). Thus, the meanings ascribed to the same term 'speculative business/transaction' under the two sections is not in pari materia. This leads to the question that if certain transactions are not considered as speculative transactions as per section 43(5) of the Act, whether such transactions could still be considered as constituting speculative business for the purposes of section 73 of the Act.

The aforesaid issue came for consideration before the Delhi High Court in the case of *CIT vs. DLF Commercial Developers Limited [2013] (35 taxmann. com 280)*. Brief facts and the decision of the High Court in the said case are as follows:

Facts – In this case, the assessee incurred loss on trading in derivatives and claimed such loss as business loss relying on section 43(5)(d) of the Act. However, the Assessing Officer rejected the contention of the assessee and held that Explanation to section 73 of the Act was applicable in assessee's case and pursuant to this the loss incurred by the assessee was speculation loss. The Tribunal accepted the contention of the assessee and held that the loss incurred on trading in derivatives was not speculation loss in view of provisions of section 43(5)(d) of the Act. The Revenue, aggrieved by the order of the ITAT, preferred an appeal before the High Court.

Decision – The term 'speculative transaction' has been defined only in section 43(5) of the Act and it is qualified i.e. the scope of definition is restricted to sections 28 to 41 of the Act. In terms of Explanation to section 73 of the Act, in case of a company, business of purchase and sale of shares is deemed to be speculation business.

The assessee's contention that the legislature intended that derivative transactions are also excluded from the mischief of Explanation to section 73 of the Act, is not substantiated. Though the expression speculative transaction is defined only in section 43(5) of the Act and it excludes exchange traded derivatives from the scope of speculative transactions, such derivatives have not been excluded from the purview of section 73 of the Act. A definition enacted for a restricted purpose or objective should not be applied to achieve other ends or purposes.

Derivatives fall within the mischief of Explanation to section 73 of the Act as the underlying asset (i.e. stock and shares) itself does not qualify for the benefit and derivatives are entirely dependent on stock and shares for determination of their value. Accordingly, loss incurred on exchange traded derivatives fell within the mischief of Explanation to section 73 of the Act.

A perusal of the aforesaid judgment reveals that the High Court came to the conclusion that even if certain transactions are not considered as speculative transactions for the purposes of section 43(5) of the Act, still the said transactions could be considered as constituting a speculation business as far as section 73 of the Act is concerned. The aforesaid judgment appears to be based on a literal interpretation of the provisions of the Act which may lead to certain unintended consequences as discussed below.

Intention behind segregation of losses between speculative and non-speculative

The High Court has held that section 43(5)(d) of the Act is relevant only for the purpose of computation of income under sections 28 to 41 of the Act and the same does not extend to section 73 of the Act; Section 73(4) has been enacted to clarify beyond any shadow of doubt that share business of certain types of companies are deemed to be speculative and since derivatives are based on stocks and shares, they squarely fall within the Explanation to section 73 of the Act.

At this stage, one needs to look at the intention for segregation of profits and losses between speculation business and non-speculation business. The said intention is manifest in section 73 of the Act which provides that losses of speculation business shall be eligible for set-off only against profits of speculation business;

further, speculation losses which could not be completed set-off in the year of incurrence are allowed to be carried forward for set-off against speculation profits for a maximum period of four years from the end of the year in which such losses were first computed (as against a period of eight years available in case of non speculation business losses). Thus, there are restrictions with regard to set-off and carry forward of speculation losses in comparison to non-speculation losses.

Sections 28 to 41 of the Act prescribe the mechanism for computation of business income (including speculation business) and these sections do not make any discrimination between a speculation or a non-speculation business.

In the aforesaid scheme of things, let's assume that a taxpayer has incurred losses from trading in derivative transactions executed on a recognised stock exchange. The losses incurred by the taxpayer should be considered as business losses for the purposes of sections 28 to 41 of the Act in accordance with section 43(5)(d) of the Act. However, as mentioned above, Sections 28 to 41 of the Act are merely computation provisions and do not discriminate between speculation and non speculation business. Thus, characterisation of the losses incurred by the taxpayer as business losses does not seem to have any implication.

If, on the other hand, the losses incurred by the taxpayer are considered as arising from speculation business considering the provisions of section 73 of the Act (as was done by the High Court in DLF's case), the taxpayer would not be eligible to set-off such losses against other business income. In such eventuality, the provisions of section 43(5)(d) of the Act would lose their relevance as no implication would follow as a result of consideration of losses incurred by the taxpayer as business losses. It is humbly submitted that it is a settled position that any interpretation which leads to a particular provision of the Act becoming redundant or otiose should be avoided.

Further, in certain situations, the interpretation suggested by the Delhi High Court may lead to absurd results – for example a trader enters into certain over the counter forward contracts for purchase of certain commodity which eventually are settled in cash i.e. without giving or taking delivery of the underlying commodity. As per the provisions of section 43(5) of the Act, the said transaction should get classified as speculative transaction. However, as per the Delhi High Court's decision the classification into business income or speculation as per section 43(5) of the Act should be confined to sections 28 to 41 of the Act (for the reason that any term defined has contextual relevance). As per Section 73 of the Act, for a business to get classified as speculative, the same must relate to purchase and sale of shares (subject to satisfaction of other conditions). Thus, the transactions entered into by the taxpayer in the example mentioned above should not get classified as speculation business for the purposes of section 73 as the said transactions do not relate to purchase and sale of shares and consequently the restrictions contained in section 73 of the Act with regard to set-off and carry forward of speculation loss should not apply to such a situation.

It may also be pertinent to note that the Explanation to section 73 applies only in case of corporate assessees. Therefore, if the interpretation adopted by the Delhi High Court is relied upon, non corporate assessees cannot have losses from speculation business.

Deeming fiction of Explanation to section 73

The Explanation to section 73 of the Act creates a deeming fiction by treating the losses arising from purchase and sale of shares as speculation loss. The said deeming fiction applies even to cases where such purchase and sale transactions are settled by actual deliveries.

It is a settled position that a deeming fiction created must be construed strictly. The Delhi High Court in DLF's case has extended the applicability of Explanation to section 73 of the Act even to derivatives whereas the Explanation

to section 73 of the Act only talks about shares. While doing so, the High Court held that since derivatives are based on stock and shares which squarely fall within the Explanation to section 73, it is idle to contend that derivatives do not fall within that provision when the underlying asset itself does not qualify for the benefit.

Though the stock derivatives derive their value from the underlying stock and shares, it is humbly submitted that still the said stock derivatives cannot be equated to the underlying stock and shares. This is for the reason that when a person acquires a stock derivative, he does not acquire and rights which are associated to the ownership of the underlying shares (such as right to vote in the meetings of the company, right to receive dividend, etc.). In case of stock derivatives only the value of derivatives is pegged to the underlying shares; however, that by itself should not make the stock derivatives as equivalent of underlying shares.

Before insertion of clause (d) in the proviso to section 43(5) of the Act, various appellate authorities had discarded the aforesaid line of argument (viz. transactions in stock derivatives cannot be equated to transactions in shares) in the context of section 43(5) of the Act. However, there is a fundamental difference between the provisions of section 43(5) of the Act and provisions of section 73 of the Act. Section 43(5) of the Act provides a very general definition of the speculative transaction as any transaction for purchase and sale of any commodity, including stock and shares, which is ultimately settled otherwise than by actual delivery. As derivative transactions have underlying as stock and shares and are settled without delivery of underlying stock and shares, the appellate authorities held that such transactions are speculative transactions as per section 43(5) of the Act. However, such reasoning cannot apply in case of Explanation to section 73 of the Act which creates a deeming fiction only in relation to shares.

Genesis of Explanation to section 73

It may not be out of context to analyse the intention for insertion of Explanation to section 73 of the Act. The said Explanation was inserted by Taxation Laws (Amendment) Act, 1975. The Circular explaining the provisions of the Amendment Act mentioned the object for insertion of Explanation to section 73 as follows:

The object of this provision is to curb the device sometimes resorted to by business houses controlling groups of companies to manipulate and reduce the taxable income of companies under their control.

With technological developments in the stock markets, trading in derivatives happens through online terminals where the identity of the buyers and sellers remains anonymous. Considering this, the malpractice sought to be prevented by Explanation to section 73 does not arise under the current mechanism of trading in derivatives. Thus, even considering the intent with which Explanation to section 73 was introduced, the rigours of the said Explanation should not be extended to derivatives traded on a recognised stock exchange.

Conclusion

The judgment of the Delhi High Court in DLF's case is primarily driven by the fact that section 43 of the Act defines certain terms for the purposes of computation of income under sections 28 to 41 of the Act and since the definition of the term 'speculative transactions' and exclusions thereto is mentioned in section 43(5), the said definition is relevant only for the purposes of section 28 to 41 of the Act. It appears that the attention of the High Court was not drawn to the fact that application of Explanation to section 73 of the Act *de hors* the provisions of section 43(5) of the Act may result into unintended consequences as mentioned above. Be that as it may, it would be interesting to see how the other High Courts or the Supreme Court approach the issue.

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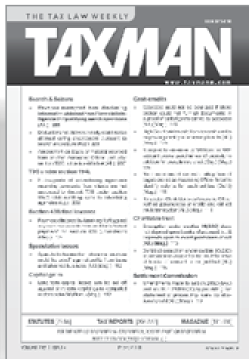

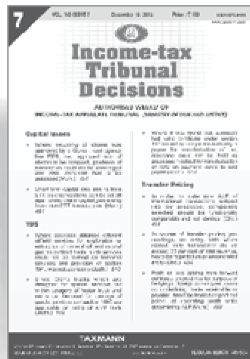

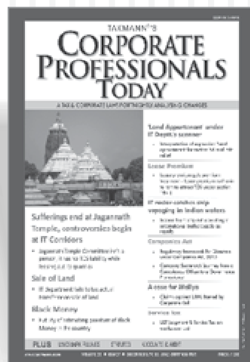

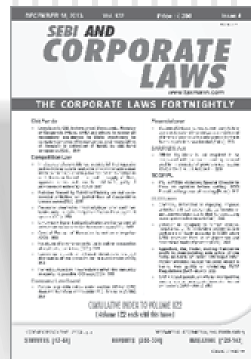

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B.V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

S. 260A(4): High Court has power to hear the appeal on questions not formulated at the stage of admission of the appeal

CIT vs. Mastek Limited (Supreme Court) (Petition(s) for Special Leave to Appeal (Civil)....../2013 CC 3075/2013) dated 4th March, 2013.

The Revenue filed an appeal u/s 260A in the High Court in which it raised several questions. The High Court admitted the appeal and framed two substantial questions of law. The Revenue filed a SLP claiming that by necessary implication, the other questions raised in the memo of appeal before the High Court had been rejected.

Dismissing the SLP the Supreme Court held that the Revenue is under some misconception. The High Court's power to frame substantial question(s) of law at the time of hearing of the appeal other than the questions on appeal has been admitted remains under section 260A(4). This power is subject, however, to two conditions, (i) the Court must be satisfied that appeal involves such questions, and (ii) the Court has to record reasons therefor.

Ss. 132B(4)(b)/240/244A: Assessee is entitled to interest on cash appropriated during search even if refund is directed in appeal proceedings

Chironjilal Sharma HUF vs. Union of India and Others Civil Appeal No. 10601 of 2013 [Arising out of S.L.P. (C) No.. 20381 of 2012] 26th November, 2013.

Pursuant to a search conducted u/s. 132, cash of ` 2.35 lakhs was recovered. The AO passed an order u/s. 132(5) in which he calculated the tax liability and appropriated the seized cash. An assessment order was also passed to the same effect. The AO's order was finally set aside by the Tribunal and it became final. Consequently, the assessee was refunded the amount of ` 2.35 lakhs with interest from 4-3-1994 (date of last of the regular assessments by the AO) until the date of refund. The assessee claimed that he is entitled to interest u/s. 132B(4)(b) of the Act for the period from the expiry of period of six months from the date of order u/s. 132(5) to the date of regular assessment order. In other words, as the order u/s. 132(5) was passed on 31-5-1990, six months expired on 30-11-1990 and the last of the regular assessments was done on 4-3-1994, the assessee claimed interest u/s. 132B(4)(b) from 1-12-1990 to 4-3-1994.

The Supreme Court held that the department's argument that the refund of excess amount is governed by sec. 240 and that s. 132B(4)(b) has no application is not acceptable. Sec. 132B(4)(b) deals with pre-assessment period and there is no conflict between this provision and sec. 240 or for that matter sec. 244A. The former deals with pre-assessment period in the matters of search and seizure and the later deals with post-assessment period as per the order in appeal. The department's view is not right on the plain reading of sec. 132B(4)(b) and the assessee is entitled to simple interest at the rate of 15% per annum u/s. 132B(4)(b) from 1-12-1990 to 4-3-1994. The interest shall be paid within two months from today.

Ashok Patil, Mandar Vaidya & Priti Shukla
Advocates

DIRECT TAXES
High Court

1. Section 271(1)(c) – No penalty can be levied merely on basis of inflated stock statement given to bank for purpose of availing overdraft facilities

CIT vs. Sachidanand Pulse Mills [2013] 39 taxmann.com 159 (Gujarat)

The assessee availed overdraft facility for the purpose of accommodating existing bank finances against hypothecation of stock. He provided stock statements to bank in support of it. During assessment proceedings, the Assessing Officer found difference in stock between stock statements given to bank by the assessee and stock as per the books of account. Accordingly, he imposed penalty under section 271(1)(c). The Commissioner (Appeals) dismissed the assessee's appeal. However, the Tribunal deleted the penalty on ground that no concealment of income was found. On an appeal, it was found that there was as such no concealment by the assessee and considering the case on behalf of the assessee that the stock statement given to the bank was purely for the purpose of accommodating existing bank finances and the assessee was required to submit stock statement showing a particular value of the stock in order to continuously enjoy overdraft facility and whatever was submitted before the bank was disclosed before the authority and, therefore, as such there was no concealment. The court held that the Tribunal has rightly deleted the penalty imposed under section 271(1)(c) and no substantial question of law arose in that present appeal.

2. Section 158BC – Computation of undisclosed income for the block period has to be determined on the basis of evidence found as the result of search and requisition of books and documents

CIT vs. Dr. Ratan Kumar Singh (2013) 95 DTR (All) 458

Search and seizure action was conducted at the residential premises of the assessee. No cash, bullion, jewellery or any material including investments were found. AO estimated the income on the basis of register found from business, without rejecting books of accounts The High Court held that income of the block period has to be determined on the basis of evidence found as a result of search, and it is not open to the AO to compute the income on the basis of best judgment.

3. Section 271D – No reasonable cause – Penalty leviable

Mahak Singh vs. CIT [2013] 37 taxmann.com 390 (Allahabad)

The assessee took loan from four parties in cash of ` 2 lakh each. Since the transactions were above ` 20,000, the Assessing Officer opined that there was violation of provisions of section 269SS. The assessee explained that he had mortgaged his agricultural land with a bank against loan taken from it. On his failure to repay loan amount, the bank had initiated attachment proceedings. Thus, in order to protect his agricultural land from being sold in open market, assessee borrowed aforesaid land in cash in hurry so as to repay bank loan. The Assessing Officer rejected assessee's explanation and passed a penalty order under section 271D. On appeal in High Court, the High Court dismissed the appeal of the assessee and held that in the present case, concurrent findings have been recorded by the Assessing Officer, the Commissioner (Appeals) and the Tribunal that the assessee could not establish that he had to arrange the money in hurry to save the honour of family. The entire story of the urgency to raise loans set up by the assessee as a reasonable cause for non-compliance of section 269SS was not believed by the revenue authorities and, thus, even if the transaction was genuine and *bona fide*, the explanation for non-compliance of the provisions of section 269SS was not found acceptable. Whether there was any reasonable cause for non-compliance of section 269SS, was findings of fact. The Tribunal was the last forum for recording such findings. In the present case, all the revenue authorities including the Tribunal have concurrently held that there was no reasonable cause inasmuch as the story set up by the assessee to arrange the money in hurry to save the honour of the family was not proved, the assessee would not get the benefit of section 273B. Therefore assessee's appeal was dismissed.

4. Section 115JA – Question of method of computation of book profit u/s. 115JA could not arise in High Court

Ester Industries Ltd. vs. CIT (2013) 219 Taxmann 19 (Del)

The assessee for the year 1997-98 declared the taxable income as nil. The assessee company did not compute taxable income under provisions of section 115JA and attached a note with return that said provisions were not applicable. Assessing Officer calculated tax payable under section 115JA at ` 4.07 crores. Both CIT(A) & Tribunal upheld the order of Assessing Officer. Assessee submitted before High Court that adjustments required for computing book profits under section 115JA had been wrongly made by the Assessing Officer. Before the Tribunal, assessee did not challenge manner of computation of book profit made by the Assessing Officer. Hon'ble High Court dismissed the appeal of the assessee and held that as per the grounds of appeal raised before the Tribunal, the assessee never challenged the computation made under section 115JA or challenged or questioned the assessment order on the ground that adjustments had not been made as required and mandated by law. Further the court also held that assessee now in Fourth Appeal could not be allowed and permitted to raise contention with regard to computation of book profit u/s 115 JA.

> "Physical fitness is not only one of the most important keys to a healthy body, it is the basis of dynamic and creative intellectual activity."
>
> *— John F. Kennedy*

Jitendra Singh & Sameer Dalal
Advocates

DIRECT TAXES
Tribunal

REPORTED

1. Block assessment – Section 158BD of the Income-tax Act, 1961 – Recording of satisfaction – Satisfaction under section 158BD of the Act recorded by the Assessing Officer other than the Assessing Officer of searched party – Not valid notice – Section 158BD of the Income-tax Act, 1961 – Block Assessment – Notice under section 158BD of the Act issued after a lapse of almost 6 (six) years from the date of search not sustainable. Block Periods: 1-4-1990 to 2-4-2000

Anees Firoz Sarkar vs. Asstt. CIT – (2013) 96 DTR 136 (Ahd.)

During the course of a search action conducted under section 132 of the Act on 27-4-2000 in case of a person, documents were found in respect of sale of a plot. Accordingly, the AO of the searched party had recorded satisfaction in respect of a company and on the basis of the satisfaction of the Assessing Officer of the searched party, notice under section 158BD was issued and the proceedings were initiated against the company but, the proceedings were dropped by the concerned Assessing Officer as the company was not incorporated at the relevant time. However, the Assessing Officer of the company through his higher officer informed the Assessing Officer of the assessee that the income was assessable in the hands of the assessee. Accordingly, notice under section 158BD was issued in the assessee's case on 23-3-2006 and assessment was framed under section 158BD in the assessee's case.

On appeal before the Tribunal it was argued that the Assessing Officer of the searched party had stated that a plot of land was purchased in the name of company and request was made to the concerned Assessing Officer to take action under section 158BD of the Act against the company. There was nothing on record to suggest that the Assessing Officer of the searched party had recorded satisfaction in case of the assessee. Therefore, the action of the Assessing Officer to frame assessment under section 158BD of the Act in respect of the assessee was illegal and bad in law. Further it was argued that, search operation was carried out on 27-4-2000 and notice under section 158BD of the Act was issued to the assessee on 29-3-2006 and served upon the assessee on 20-4-2006, that is, nearly

after 6 (six) years from the date of search, as such, on this ground also, the action of the Assessing Officer was not sustainable.

The Tribunal quashing the block assessment proceedings held that, if the Revenue authorities under the Act intends to proceed against an assessee under section 158BD of the Act, the Assessing Officer of the searched party should record his satisfaction that the income belongs to the assessee. In the present case, the satisfaction recorded by the Assessing Officer was not valid as the same was recorded by the Assessing Officer other than the Assessing Officer of the searched party that is, the Assessing Officer of the Company in whose case 158BD proceedings were initiated and dropped. Further, the Tribunal held that proceedings under section 158BD of the Act were not sustainable in the present case as, the search was conducted on 27-4-2000 and notice under section 158BD of the Act was issued on 29-3-2006, that is, after a lapse of nearly 6 (six) years. The Tribunal held that even though no limitation is provided under the Act for issuance of notice under section 158BD of the Act, the proceedings are required to be initiate within a reasonable time proceedings cannot be initiated after a lapse of many years. Thus, notice under section 158BD of the Act issued after lapse of almost 6 (six) years from the date of search was held to be bad in law.

2. Powers of Commissioner of Income Tax (Appeal) – Section 251 of the Act – Appellate Authority has no power to give direction to A.O. in relation to a third person whose appeals are not pending before it. A.Y.: 2003-04

Vijay Kumar Sarda vs. Dy. CIT [2013] 40 taxmann.com 113 (Mumbai - Trib.)

During the course of assessment, the A.O. found that assessee's wife had purchased a property and paid certain sum to landlord for transfer of flat in her name. In the same building several other purchasers got the flats transferred in their names wherein they had paid some amount to the person who was holding tenancy rights apart from paying a stipulated sum to the landlord. The Assessing Officer observed that certain amount must have been paid for surrendering of tenancy rights and for handing over. The assessee's wife denied of making any payment. However, the A.O. while passing the assessment order, assumed that the assessee's wife might have also paid certain amount for surrender of tenancy rights out of unaccounted source of income and further assumed that this payment would have been made from the unaccounted money of the assessee, since assessee's wife is only a housewife. Accordingly, addition was made in the hands of the assessee.

Being aggrieved by the assessment order passed, the assessee preferred an appeal before the First Appellate Authority. The Learned CIT(A) passed the appellate order wherein he observed that the assessee's wife had acquired the flat on payment of certain premium. Therefore, he directed the A.O. to assess the entire unaccounted payments in the hands of the assessee's wife by invoking provisions of section 150(1) for relevant assessment year. The assessee being aggrieved again carried the matter further to the Income Tax Appellate Tribunal, Mumbai. Hon'ble Appellate Tribunal quashed the direction issued by the Learned CIT(A) and held that Appellate Authority cannot give directions to Assessing Officer in relation to a third person, whose appeal is not pending before him.

3. Revision under section 263 – Commissioner cannot revise an order on grounds which were

not mentioned in the show cause notice particularly when A.O. while passing the assessment order made detailed inquiry. A.Y.: 2007-08

Smt. Kamla Goil vs. CIT [2013] 39 taxmann.com 104 (Jodhpur - Trib.)

The A.O. finalised the assessment of the assessee under section 147 r.w.s. 143(3) of the Act after detailed enquiry and made certain lump sum addition. The Commissioner exercised his revisionary jurisdiction under section 263 of the Act on ground that the A.O. had not properly investigated the items of income and had made assessment in haste. The CIT issued show cause notice under section 263 of the Act on purchase and sale of immovable properties. The assessee in reply to the said show cause notice filed a detailed reply. The CIT after considering the reply filed by the assessee set aside the assessment order by treating the same as erroneous as well as prejudicial to the interest of revenue. However, the Commissioner revised the assessment order on an entirely different issue. The assessee being aggrieved by the order passed under section 263 of the Act preferred an appeal before the Hon'ble Appellate Tribunal at Jodhpur. The Appellate Tribunal quashed the revision order passed under section 263 of the Act and held that the Commissioner cannot revise an order on grounds regarding which the assessee was not show caused. Otherwise also the assessment order was made under section 147/148 read with section 143(3) and the A.O. has computed assessee's income after making reasonable and due inquiries. The assessee is not found to have been indulging in the purchase and sales of any immovable property. Therefore, twin conditions of section 263 were not fulfilled and, thus, the order could not be revised.

UNREPORTED

1. Assessment – Section 139 of the Income-tax Act, 1961 – Revised computation of income – Where the assessee files a computation of his income during assessment proceedings, and is able to convince Assessing Officer that income disclosed in original return was incorrect income and correct income was furnished in the revised computation filed in assessment proceedings – The revised computation has to be considered and acted upon by Assessing Officer. A.Y.: 2007-08

Mit Mohan Singh Kahlon vs. Dy. CIT – [I.T.A. No. 57 / Chd. / 2012; Order dated 16-4-2013; Chandigarh Tribunal]

The assessee in his return of income declared total income at ` 51,09,290. Notice under section 143(2) was issued to the assessee selecting his case for scrutiny assessment. During the assessment proceedings, the assessee submitted that his total income for the year under consideration, was on a lower side and not as shown in the return filed originally. In order to substantiate his claim he filed various details, he was also explained that sources of income declared in his return of income were the only sources of his income and the assessee did not have any other taxable source of income. Through computation of income, the assessee tried to explain the possible mistakes committed, which resulted in higher income and disclosed in the original return.

The Assessing Officer, rejected explanation of the assessee and assessed the returned income as per return of income, ignoring the revised computation filed during the assessment proceedings before him.

On appeal the Tribunal held that it is true and undeniable that the assessee filed his valid return of income in which total taxable income has been disclosed at a higher figure. But during assessment proceedings, the assessee filed revised computation of his total income wherein a lower income was declared and which he was able to substantiate. In such a case, one should not forget that under the Act, only correct income can be taxed in the hands of a right person and the derivation of correct income is not only the requirement of the Act but it is the fiduciary duty cast on the Assessing Officer by the precincts of the Act. Thus, where the assessee files and produces correct computation of his income, and can convince the Assessing Officer that the income disclosed in the original return is not actually the correct income and the correct income is the one which is being furnished during assessment proceedings, such a revised computation has to be considered and acted upon this way or that way. Such a computation cannot be ignored with reference to sections 139(1), 139(4) and 139(5) on technicalities.

2. Reassessment – Section 147 of the Income-tax Act, 1961 – Assessment completed under section 143(3) read with section 147 without issuing notice under section 143(2) – Assessment order passed held to be legally and unsustainable. A.Y. 1999-2000

ADIT (E) vs. Vodithala Education Society –[I.T.A. No. 55 / Hyd. / 2011; Order dated 13-9-2013; Hyderabad Tribunal]

The assessee had filed its return beyond the due date prescribed under section 139(1) or under section 139(4) of the Act, the Assessing Officer treated the return as non est. Thereafter the Assessing Officer issued notice under section 148 reopening the assessment. In the course of reassessment proceedings objections were called for reopening the assessment and the reassessment proceedings were completed under section 143(3) read with section 147 rejecting the contention of the assessee and without issuing any notice under section 143(2).

On appeal the Tribunal held that the requirement of issuing notice under section 143(2) is a mandatory requirement and not a curable procedural irregularity. The Assessing Officer having proceeded to make an assessment under section 143(3) read with section 147, notice under section 143(2) should have been issued to the assessee before completing the reassessment proceedings.

3. Penalty – Section 271(1)(c) of the Income-tax Act, 1961 – During course of search conducted under section 132 assessee offered an amount as additional income under the statement recorded under section 132(4) of the Act and thereafter in his return in response to section 153A of the Act and offered the additional income for taxation – Assessing Officer completed the assessment accepting the revised return – Held penalty under section 271(1)(c) of the Act not sustainable on agreed addition. A.Y.: 2007-08

Dilip Kedia vs. Asstt. CIT – [I.T.A. No. 1986 / Hyd. / 2011; Order dated 26-7-2013; Hyderabad Tribunal]

During the course of search conducted at the premises of the assessee on 1-2-2008, the assessee made a statement under section 132(4) and offered an amount of ` 50 lakhs

as additional income for the assessment year 2007-08. Thereafter, he filed the original return of income for the assessment year 2007-08 on 7-7-2008. Subsequently pursuant to notice issued under section 153A filed a return on 12-11-2008 and offered the aforesaid additional income of ` 50 lakhs for taxation.

The Assessing Officer framed the assessment under section 153A, accepting the revised return without any further additions. Thereafter, he levied the penalty under section 271(1)(c) on the agreed addition.

On appeal by the assessee the Tribunal deleting the penalty held that as per the existing Explanation 5A, prior to the amendment by the Finance Act, 2009, if an assessee had filed the return of income for the years covered by the search, then the addition made shall not be considered as deemed concealment. It is only by the amendment to Explanation 5A by the Finance Act, 2009, the addition made in the course of assessment under section 153A will be deemed to be concealed income, even if the assessee had filed a return of income earlier for the relevant assessment year. Even though the amendment to Explanation 5A has been made with retrospective effect from 1-6-2007, it is well settled that the law prevailing as on the date of filing of return should be the basis of levy of penalty and not on the subsequent amendment, even if the amendment is retrospective. In the instant case, the assessee had filed return of income on 7-7-2008 and thereafter, return pursuant to notice under section 153A on 12-11-2008. Thus, both the original return as well as the revised return were filed before the amendment to Explanation 5A became a part of the statute. Further the Tribunal held that Assessing Officer had not brought on record any other materials or evidence for coming to conclusion that assessee had concealed any income except for statement recorded under section 132(4), levy of penalty upon assessee merely on such a statement was not justified.

4. Business expenditure – Section 37(1) of the Income-tax Act, 1961 – Allowability – If there is continuity of business with common management and fund, then even if assessee has started a new line of business in relevant year, payment made for carrying out such running of new business has to be allowed as business expenditure. A.Y.: 2005-06

Agrani Telecom Ltd. vs. Asstt. CIT – [I.T.A. No. 981 / Mum. / 2011; Order dated 13-9-2013; Mumbai Tribunal]

The assessee was in business of trading and transportation service. During the relevant assessment year it entered into business of fleet management service and providing security products and networking solution, for which it had hired a consultant who had provided advisory services and had also contributed in identifying prospective customers. The Assessing Officer disallowed charges paid to consultant on ground that same related to new line of business.

On appeal the Tribunal held that, if there was continuity of business with common management and funds, then even if assessee had started a new line of business in relevant assessment year, payment made for carrying out such running of business was nothing but a business expenditure which had to be allowed in year in which it had been incurred.

CA Sunil K. Jain

DIRECT TAXES
Statutes, Circulars & Notifications

Notifications

Section 43(5), Clause (iii) of Explanation 2 to Clause (e) of proviso, of the Income-tax Act, 1961 – Speculative transaction – Notified recognised stock exchange

The Central Government notified the National Commodity and Derivatives Exchange Limited, Mumbai, Universal Commodity Exchange Limited, Mumbai and Multi Commodity Exchange of India Limited, Mumbai as a recognised association(s) for the purposes of clause (e) of the proviso to clause (5) of the said section, with effect from the date of publication of these notification(s) in the Official Gazette. The Central Government may withdraw the recognition of aforesaid exchange(s) if any of the conditions specified in rule 6DDC of the Income-tax Rules, 1962, is violated. The notification(s) shall remain in force until the approval granted by the Forward Markets Commission is withdrawn or expires, or the notification is rescinded by the Central Government under sub-rule (5) of rule 6DDD of the Income-tax Rules, 1962.

(Notification Nos. 90-91/2013 respectively both dated 27-11-2013 and 92/2013 dated 29-11-2013)

Inflation Indexed National Savings Securities – Cumulative, 2013

The Government of India notified the issue of Inflation Indexed National Savings Securities – Cumulative, 2013 ("the Bonds") from December 23, 2013 to December 31, 2013 while reserving the right to close the issue earlier than December 31, 2013 with a limit of ` 5 lakh per applicant.

The distribution/sale of IINSS-C would be through banks. The eligible investors would include individuals, Hindu Undivided Family (HUF), Charitable Institutions registered under section 25 of the Indian Companies Act and Universities incorporated by Central, State or Provincial Act or declared to be a university under section 3 of the University Grants Commission Act, 1956. Interest rate on these securities would be linked to final combined Consumer Price Index [CPI (Base: 2010=100)]. Interest rate would comprise two parts, i.e. fixed rate (1.5% per annum) and inflation rate based on CPI and the same will be compounded in the principal on half-yearly basis and paid at the time of maturity. Early redemptions will be allowed after one year from date of issue for senior citizens (i.e., above 65 years of age) and 3 years for all others, subject to penalty charges at the rate of 50% of the last coupon payable for early redemption. Early redemptions, however, can be made only on coupon dates.

The other terms and condition of the issue of the Bonds, issue price, tenure, application form and repayment periods etc. have been provided in the said notification.

(Notification No. dated 19-12-2013)

Section 10(46) of the Income-tax Act 1961 – Exemptions – Statutory body/Authority/Board/Commission – Notified

The Central Government notified for the purposes of the above clause, the Kerala Stale AIDS Prevention Society a body constituted by the Government of Kerala in respect of the specified income arising to that Society, on account of :

> *"amount received in the form of grants-in-aid from the Centre Government"*

The notification shall be deemed to have been applied for the financial years 2011-2012 and 2012-13 and shall be applicable for the financial years 2013-14, 2014-15 and 2015-16 respectively. The notification shall be effective subject to the following conditions, namely:—

(a) the Kerala State AIDS Control Society does not engage in any commercial activity;

(b) the activities and the nature of the specified income of the Kerala State AIDS Control Society remain unchanged throughout the financial year; and

(c) the Kerala Slate AIDS Control Society files return of income in accordance with the provision of clause (g) of sub-section (4C) section 139 of the Income-tax Act, 1961.

The grants received by the said Society shall be received and applied in accordance with the prevailing rules and regulations.

(Notification No. 95/2013, dated 19-12-2013)

Circulars

Section 92CB of the Income-tax Act, 1961 – Transfer Pricing – Safe harbour rules – Analyses of Form 3CEFA received while opting for safe harbour

CBDT made the Safe Harbour rules public *vide* notification dated 18th September, 2013. In order to analyse the number of taxpayers opting for the Safe Harbour, the board has requested to provide the following information from the return of income filed till 30th November, 2013:

Name, address, PAN and Assessing Officer of the taxpayer filing Form 3CEFA

Details of eligible international transaction for which benefit under Safe Harbour Rules has been opted.

It also requested to provide the above-mentioned details by 5th December, 2013.

(Letter - Dated 28-11-2013)

Section 2(22AAA), read with section 13B of the Income-tax Act, 1961 – Electoral trust – Standardising process of filing application for approval of an electoral trust

Under clause (22AAA) of section 2 of the Income-tax Act, 1961 Central Board of Direct Taxes is empowered to approve an 'Electoral Trust' for the benefit of provisions of section 13B of the Income-tax Act, 1961.

Clause 5(1)(a) of the Electoral Trust Scheme, 2013, requires an application for approval under section 2(22AAA) of the Act to be made in duplicate in Form A. In order to avoid procedural delay in processing these applications, the applicants have been advised to file alongwith the application in Form A, on or before the prescribed date, the duly filled in and signed check-list accompanied with documents required therein, before the Commissioner of Income Tax/Director of Income Tax under whose jurisdiction their cases fall. The applicant should also enclose a copy the said check-list as now provided while sending the copy of their application to Member (IT), CBDT in terms of clause 5(1)(b) of Electoral Trust Scheme, 2013.

(Letter - Dated 10-12-2013)

Extension of last date of payment of December quarter instalment of Advance Tax for Financial Year

2013-14 from 15-12-2013 to 17-12-2013 for all Assessees, Corporates and other than Corporates

The Central Board of Direct Taxes extended the last date of payment of the December Quarter Instalment of Advance Tax for the Financial year 2013-14, from 15th December, 2013 to 17th December 2013 for all the assessees, Corporate and other than Corporate

(Order - Dated 13-12-2013)

Section 40(a)(ia) of the Income-tax Act, 1961 – Business disallowance –Interest, etc., paid to resident without Deduction of Tax at Source – Clarification regarding conflicting interpretations by judicial authorities on applicability of provisions of section 40(a)(ia) with regard to amount not deductible in computing income chargeable under head 'Profits and gains of Business or Profession':

The CBDT noticed that there are conflicting interpretations by judicial authorities regarding the applicability of the provisions of section 40(a)(ia) of the Income-tax Act, 1961 ('the Act') with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'.

The section reads as under:

"…any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139...":

The Board cited as below:

1. In the case of *Merilyn Shipping & Transports vs. Addl. CIT [2012] 20 taxmann.com 244 (Visakhapatnam)* it was held by Special Bench of ITAT, Vishakhapatnam, that the provisions of section 40(a)(ia) of the Act would apply only to the amount which remained payable at the end of the relevant financial year and could not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source. The order of the Special Bench has since been put under interim suspension by the Andhra Pradesh High Court.

2. Further the Hon'ble Calcutta High Court and Hon'ble Gujarat High Court in the case of *Commissioner of Income-tax, Kolkata-XI vs. Crescent Exports Syndicate [2013] 33 taxmann.com 250 (Calcutta)* and *Commissioner of Income-tax-IV vs. Sikandarkhan N Tunvar [2013] 33 taxmann.com 133 (Gujarat)* respectively, have held that section 40(a)(ia) of the Act would cover not only the amounts which are payable at the end of the previous year but also which are payable at any time during the year.

3. The Hon'ble High Courts have further held that the intention of the legislation was to disallow certain types of expense, subject to provisions of Chapter XVII-B which is payable at any time during the year but no tax was deducted at source or if deducted was not paid within the stipulated time. There is no such condition that amount should remain payable at the end of the year.

4. The Hon'ble *Allahabad High Court in CIT vs. Vector Shipping Service (P.) Ltd. [2013] 38 taxmann.com 77* (Allahabad) has affirmed the decision of the Special Bench in Merilyn Shipping that for disallowance under section 40(a)(ia) of the Act, the amount should be payable and not which has been paid during the year. However, the decisions of the Hon'ble Gujarat and Calcutta High Courts (supra) were not brought to the attention of the Hon'ble Allahabad High Court.

5. In the case of *ACIT, Circle 4(2), Mumbai vs. Rishti Stock and Shares Pvt. Ltd. in ITA No. 112/*

Mum/2012, Hon'ble ITAT, Mumbai in its order dated 2-8-2013 has examined the decision of the Hon'ble Allahabad High Court (supra) as regards to section 40(a)(ia) of the Act and concluded that the same was an 'orbiter dicta' while the decisions of the Hon'ble Gujarat and Calcutta High Courts (supra) were 'ratio decidendi'. The ITAT accordingly applied the view taken by the Hon'ble Gujarat and Calcutta High Courts as ratio decidendi prevails over an orbiter dicta.

- Therefore after careful examination of the issue, the Board expressed its considered view that the provision of section 40(a)(ia) of the Act would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia) of the Act the term "payable" would include "amounts which are paid during the previous year".
- The CBDT also directed that where any High Court decides an issue contrary to the 'Departmental View', the 'Departmental View' thereon shall not be operative in the area falling in the jurisdiction of the relevant High Court. However, the CCIT concerned should immediately bring the judgment to the notice of the CTC. The CTC shall examine the said judgment on priority to decide as to whether filing of SLP to the Supreme Court will be adequate response for the time being or some legislative amendment is called for.

(Circular No. 10/DV/2013, dated 16-12-2013)

Instructions

Section 143 of the Income-tax Act, 1961 – Assessment – Issue of intimation under section 143(1) beyond time

The CBDT noted several instances where due to certain technical or other reasons (which *inter alia* included wrong migration of PAN and delayed release of returns by the Centralised Processing Cell to the jurisdictional authorities), intimation in refund cases could not be sent to the concerned assessees within the time-frame as prescribed in second proviso to sub-section (1) of section 143 of the Income-tax Act, 1961.This caused grievances as assessees are unable to get their legitimate refunds in accordance with provisions of Act, although the delay is not attributable to them.

The matter was examined by the Central Board of Direct Taxes, and it relaxed the time-frame prescribed in second proviso to sub-section (l) of section 143 of the Act in those cases where the return-of-income was filed by the assessee in accordance with provisions of section 139/142(1) of the Act, but due to technical or other reasons not attributable to such assessees, the date of sending intimation under section 143(1) of the Act has lapsed before 1-4-2013. In such cases, Central Board of Direct Taxes directed that such returns shall be processed and intimation of processing of such returns shall be sent to the assessee concerned by the Assessing Officer in accordance with provisions of section 143 of the Act notwithstanding the time-limit prescribed in second proviso to sub-section (1) of that section. It also directed that the progress of disposal of such cases shall be monitored by the Addl./Joint CIT. The Board further reiterated that this Instruction shall only apply to those cases where a valid return-of-income was filed as per provisions of the Act with refund claim, but the same remained pending beyond the prescribed date due to reasons not attributable to the assessee. Further, this relaxation shall not be applicable to those cases where either demand is shown as payable in the return-of-income or as a result of processing beyond the date as prescribed in second proviso to sub-section (1) of section 143, demand is determined as payable.

(Instruction No. 18/2013 – dated 17-12-2013)

Press Releases

Signing of agreement between Government of Republic of India and Government of Republic of Macedonia for Avoidance of Double Taxation and prevention of fiscal evasion with respect to taxes on income

The Republic of India and Republic of Macedonia had signed the new DTAA. Once the DTAA enters into force, it will provide relief to taxpayers from double taxation and thereby stimulate the flow of capital, technology and personnel between both the countries and will further strengthen the economic relationship between the two countries.

The agreement provides relief from double taxation to residents of India earning income in Macedonia and residents of Macedonia earning income in India. Taxation of dividend, interest and royalty in the source country will not exceed 10 per cent. Taxation of business income in the source country if the taxpayer has a permanent establishment there. Taxation of capital gains from securities in the source country. The benefit of the agreement will not be available to entity which has formed mainly to obtain benefits under this agreement.

The agreement is based on international standard of transparency and exchange of information and provides for exchange of information (including banking information) concerning taxes. The agreement has a specific provision that the requested Party shall use its information-gathering measures to obtain the requested information even though that Party may not need such information for its own tax purposes. It provides for the representatives of the competent authority of the requesting Party to enter the territory of the requested Party to interview individuals and examine records besides provision for mutual assistance in collection of taxes due in other country. This agreement is also expected to boost economic relationship between India and Macedonia.

(CBDT Press Release, dated 17-12-2013)

Signing of tax information exchange agreement between India and San Marino

India and San Marino signed a Tax Information Exchange Agreement (TIEA) at Rome, Italy. Salient features of the agreement with San Marino being that the agreement is based on international standard of transparency and exchange of information and provides for exchange of information that is foresee ably relevant to the administration and enforcement of the domestic tax laws. It has a specific provision that the requested Party shall use its information-gathering measures to obtain the requested information even though that Party may not need such information for its own tax purposes.

The agreement also provides for exchange of banking and ownership information.

Besides provision for the representatives of the competent authority of the requesting Party to enter the territory of the requested Party to interview individuals and examine records. The Agreement is expected to further strengthen tax co-operation between India and San Marino.

(CBDT Press Release, dated 20-12-2013)

"Sickness comes on horseback but departs on foot."

— *Dutch Proverb*

CA Tarunkumar Singhal & CA Sunil Moti Lala

INTERNATIONAL TAXATION
Case Law Update

A] HIGH COURT JUDGMENTS

I. Royalty – Amount received by the assessee under the license agreement for allowing the use of the software would not be royalty under the DTAA since what was transferred was neither the copyright in the software nor the use of the copyright in the software, but the right to use the copyrighted material or article which was clearly distinct from the rights in a copyright.

DIT vs. Infrasoft Ltd. [2013] 39 taxmann.com 88 (Delhi)

Facts

1. The assessee, M/s Infrasoft Ltd., is primarily into the business of developing and manufacturing civil engineering software.

2. MX software, a customised software, developed by the assessee is used for civil engineering work and for design of highways, railways, airports, ports, mines, etc. The said software is used by private consultants.

3. The assessee opened a branch office in India, which imports the package in the form of floppy disks or CDs depending on the requirements of their customers. The system is delivered to a client/customer.

4. The delivery of the system entails installation of the system on the computers of the customers and training of the customers for operation of the system.

5. The assessee *vide* its return of income, declared a loss of ` 21,75,246/-. However, the Assessing Officer ("AO") taxed the receipts on sale of licensing the software as "royalty" as per Article 12 of India-USA Double Taxation Avoidance Agreement ("the DTAA").

6. On appeal, the ITAT held that the amount received by the assessee under the licence agreement for allowing the use of the software was not royalty either under the Income-tax Act or under the DTAA.

7. Aggrieved, the Revenue filed an appeal to the Hon'ble High Court.

Judgment

1. The Hon'ble High Court referred to the decision of *DIT vs. M/s Nokia Networks OY [2012] 253 CTR (Delhi) 417* approving the Special Bench decision of *Motorola Inc vs. Deputy CIT [2005] 147 Taxmann 39 (Del) (SB), DIT vs. Ericsson A.B. [2012] 343 ITR 470 (Delhi) and TATA Consultancy Services vs. State of Andhra Pradesh [2004] 271 ITR 401 (SC).*

2. It observed that the licence is non-exclusive, non-transferable and the software has

to be used in accordance with the Agreement. Only one copy of the software is being supplied for each site. The licensee is permitted to make only one copy of the software and associated support information and that also for backup purposes. It is also stipulated that the copy so made shall include Infrasoft's copyright and other proprietary notices. All copies of the software are the exclusive property of Infrasoft.

3. The Hon'ble High Court held that there is a clear distinction between royalty paid on transfer of "copyright right" and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the royalty definition. Thus, a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of the DTAA.

4. It thus held that the incorporeal right to the software i.e. copyright remains with the owner and the same was not transferred by the assessee. The right to use a copyright in a programme is totally different from the right to use a programme embedded in a cassette or a CD which may be a software and the payment made for the same cannot be said to be received as consideration for the use of or right to use of any copyright to bring it within the definition of royalty as given in the DTAA.

5. The High Court distinguished the Karnataka High Court decision in the case of *Samsung Electronics Co. Ltd. [2012] 345 ITR 494 (Kar.)* and held that the licence granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use was only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process was necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product.

6. The Hon'ble High Court did not examine the effect of the retrospective amendment to section 9 (1)(vi) of the Act and also whether the amount received for use of software would be royalty in terms thereof as the assessee was covered by the DTAA, the provisions of which were more beneficial.

II. Writ petition disposed of with a direction to the taxpayer to first file its objections before the DRP on the basic issue of jurisdiction, i.e., whether there must be income arising and/or affected or potentially arising and/or affected by an International Transaction for application of Chapter X – Grant of opportunity of hearing before referring matter to TPO must be read into sec. 92CA(1) where jurisdiction is challenged by assessee – Vodafone can challenge DRP's decision on preliminary issue in writ petition, if DRP's decision on preliminary issue is patently illegal, notwithstanding availability of alternate remedy before ITAT

Vodafone India Services (P) Ltd. vs. UOI [2013] 39 taxamann.com 201 (Mumbai)

Facts

1. Vodafone India Services (P) Ltd. ("the petitioner"), a wholly owned subsidiary of a Mauritian Entity issued 2,89,224 equity shares of a face value of ` 10/- each at the premium of ` 8,591/- per share aggregating to a total consideration of ` 246.38 crores to its holding company.

2. For AY 2009-10, the petitioner filed its Return of Income along with Form 3 CEB in accordance with section 92E of the Act. In the said Form, the transaction of issuance of equity shares by the petitioner to its holding company (undisputedly an Associated Enterprise) was declared as an International Transaction and also the Arm's Length Price ("ALP") of the shares so issued, was also determined.

3. However, a note was appended by the accountant to its Form 3 CEB report making it clear that the transaction of issue of equity shares did not affect the income of the petitioner and was being reported only as a matter of abundant caution.

4. During the assessment proceedings, the AO referred this transaction to the Transfer Pricing Officer ("TPO") for determining ALP of this transaction of share issue.

5. Consequently, the TPO issued show cause notice ("SCN") to the petitioner. The petitioner in its replies before the TPO contended that Chapter X doesn't apply to issue of equity shares as no income arises from issue of equity shares and the transaction is a capital account transaction.

6. However, the TPO rejected assessee's contentions and observed that the issue whether any income has arisen and/or affected by the International Transaction for purposes of Chapter X would be determined by the AO. The jurisdiction exercised by him is only to determine the ALP of International Transactions and not to compute the income arising out of such International Transactions.

7. The TPO determined ALP of shares at ` 1,555.30 crores as against price charged by assessee of ` 246.38 crores. The TPO made following TP adjustments:

- The shortfall of ` 1308.92 crores as compared to ALP
- Shortfall of ` 1308.92 crores treated as deemed interest-free loan to holding company and arm's length interest of ` 88.35 crores.

8. Consequent to TPO order, the AO issued a Show Cause Notice to the petitioner. The petitioner reiterated its objections regarding application of Chapter X to issue of equity shares and also objected to re-characterisation of *bona fide* issue of shares as consisting of two transactions – Share issue & deemed loan.

9. However, the AO passed draft assessment order wherein he didn't deal with petitioner's objections on the ground that in terms of section 92CA(4) of the Act, the AO has to compute the total income in conformity with the ALP determined by the TPO. Aggrieved, the petitioner filed a writ petition before the Hon'ble Bombay High Court challenging AO's draft assessment order.

Judgment

1. The Hon'ble Court distinguished Revenue's reliance on co-ordinate bench ruling in *Vodafone India Services Pvt. Ltd. [2013] 37 taxmann.com 250 (Bom.).* It observed that as regards alternate remedy the Court in that case had also entered a caveat that the existence of alternate remedy by itself will not bar the Court from exercising its extraordinary jurisdiction if the facts of the case so warrant. Further, the fact situation in the present case is fundamentally different from the fact situation in Vodafone II case where the petitioner had submitted to the jurisdiction of the revenue authorities and had not challenged and/or protested to the same till such time the TPO had passed an order.

2. The Hon'ble High Court held that the contention of the petitioner that the filing of objections to the DRP from the draft assessment order is not an efficacious remedy on the ground that issues other than quantification/valuation could not be raised and that DRP cannot set aside any variations in draft assessment order or remand matter to AO for further enquiry is not correct in view of the judgment of Vodafone (supra). It observed that that the DRP has

jurisdiction to consider all issues including the question whether a transfer is an international transaction and the question whether income has arisen or has been affected by the international transaction.

3. It observed that declining to exercise writ jurisdiction due to availability of an alternative remedy is a rule of discretion and in an appropriate case, the Court would exercise its writ jurisdiction notwithstanding availability of an alternative remedy or mould the reliefs appropriately even while relegating the petitioner to the alternate remedy.

4. The Hon'ble High Court observed that when an assessee challenges the above premise, then the issue must be decided. Such an issue must be dealt with at the very threshold that is before determination of ALP. This is so because in case it is held that in the International Transaction there is no income or potential of any income arising and/or being affected on determination of an ALP, the entire exercise of determining the ALP would become academic.

5. In cases of transaction referred to the TPO, it would be for the AO to first determine the issue of any income arising and/or being affected or potentially arising on determination of ALP before referring the transaction to the TPO, when specifically contended by the petitioner/assessee. This is also indicated in section 92CA(1) which requires an Assessing Officer to refer an International Transaction for determination to the TPO only if he considers it "necessary or expedient" to refer the matter to the TPO. The grant of personal hearing before referring the matter to the TPO has to be read into section 92CA(1). In the absence of it being considered at this stage, the same could only be considered by the DRP.

6. It observed that as no final assessment order has yet been passed by the AO and the issues are still at large before the DRP the same could be urged before the DRP. It thus held that instead of remanding the matter to the AO to examine this question, the merits of this question must be considered by DRP under section 144C(5) read with section 144C(8). In a given case if the DRP requires any further material, DRP may exercise its powers either under section 144C(7) or (5) i.e. by directing the AO to make enquiry into this aspect of the matter and report or alternatively decide it itself and give final directions to the AO.

7. It further observed that the process before the DRP is a continuation of the assessment proceedings as only thereafter would a final appealable assessment order be passed. Till date there is no appealable assessment order. The proceeding before the DRP is not an appeal proceeding but a correcting mechanism in the nature of a second look at the proposed assessment order by high functionaries of the revenue keeping in mind the interest of the assessee.

8. The Hon'ble High Court rejected the assessee's submission that one of the members is the Director of Income Tax (Transfer Pricing) and in terms of CBDT Instruction No. 3/2003 a Director of Income Tax (Transfer Pricing) is required to approve the order passed by the TPO on the ALP and hence the hearing before the DRP would not be fair hearing as a person of equal rank has already approved the order of TPO. It observed that this submission completely overlooks the fact that the proceedings before the DRP are not appeal proceeding but a proceeding to finalise the assessment on the basis of the draft assessment order. Besides, the DRP consists of three members and does not have the Director of Income Tax (Transfer Pricing) in particular who had approved the order of the TPO as a member.

9. Accordingly, it disposed of the petition with following directions:

- The petitioner shall within two weeks submit before the DRP its preliminary objections to Draft Assessment Order and the TPO's order by raising jurisdictional issues.

- The DRP shall decide the issue of jurisdiction as a preliminary issue within two months from the date on which the petitioner files its objections on the question of jurisdiction.
- Since the question of jurisdiction for applicability of Chapter X for the A.Y. 2009-10 is raised independently of the challenge to the orders of the TPO and the AO for the A.Y. 2008-09, the DRP shall decide the preliminary issue about applicability of Chapter X to the assessment for the AY 2009-10, without awaiting the decision on the dispute relating to the A.Y. 2008-09.
- In case the decision of the DRP on the above preliminary issue is adverse to the petitioner, it would be open to the petitioner to challenge the order of the DRP on the preliminary issue in a writ petition if a case is made out at that stage that the decision of the DRP is patently illegal, notwithstanding the availability of alternative remedy of filing an appeal before the Hon'ble ITAT.

III. India – France DTAA – Interest earned by a non-resident on income-tax refund is not taxable in India at concessional rate of 10% as per the DTAA if such non-resident has a PE in India

DIT vs. Pride Foramer SAS [2013] 40 taxmann.com 100 (Uttarakhand)

Facts

The Department sought interpretation of Article 12 sub-Articles (1), (2) & (5) of the Double Taxation Avoidance Treaty between India and France ("the DTAA").

Judgment

1. The Hon'ble High Court held that a plain reading of the provisions makes it absolutely clear that sub-Articles (1) & (2) will apply *inter alia* when the recipient of interest does not have a permanent establishment in the country, where he has received interest.

2. In the instant case, there was no dispute that the assessee had a permanent place of business in India and accordingly, submitted to the taxing jurisdiction of India and paid tax on its income except income from interest under section 44BB of the Act. Thus, the interest earned in India on the refund of income tax is, therefore, not covered by sub-Articles (1) & (2) of Article 12 of the DTAA.

B) Tribunal decisions

I) Export commission paid to a non-resident director is taxable under the Income-tax Act as well as under the India-Switzerland DTAA – Held: Yes – On facts of the case, against the assessee

ITO vs. M/s. Device Driven (India) Pvt. Ltd. [TS-613-ITAT-2013 (Coch)] Assessment Year: 2009-10

Facts

1. The assessee was engaged in development and sale of software. During the year under consideration, the assessee paid export commission to its non-resident director, acting as a commission agent, without deduction of tax. The assessee claimed export commission as a deduction while computing its taxable income.

2. The agent was not having any Permanent Establishment (PE) in India. The non-resident director was a qualified architect and has got vast experience in the technical field, especially in mobile communication.

3. The terms of the commission agency agreement entered into between the assessee and commission agent provided as follows:

- The commission agent will facilitate marketing of the assessee's services in the territory and will provide support as

well as sales expertise for projects to be executed at the customer site or at the assessee's centre in India.

- The commission agent shall be responsible for generating leads and initiating interaction with end customers in the relevant competency areas of the assessee.
- The commission agent shall if required, provide support to assessee in evaluation from a business perspective, in the light of his relationships with the proposed clients and local expertise. He will also provide support to the assessee for presentations and other collateral proposals and contracts.

4. The Assessing Officer (AO) held that the terms of the agreement are beyond the scope of normal commission agency agreement, and the technical skills of the director have been utilised by the assessee. Accordingly, the payment made to a commission agent was accruing and arising in India and liable for deduction of tax. However, since the assessee did not deduct tax, the AO disallowed the payment under section 40(a)(i) of the Act. The Commissioner of Income-Tax (Appeals) [CIT(A)] upheld the order of the AO.

Decision

The Tribunal held in favour of the Revenue, as follows:

i) Reference to the terms of the agreement, indicates that the responsibilities and obligation placed upon the commission agent is more than what is normally placed upon agents working in normal business transactions.

ii) The work of the assessee does not end upon developing and installing the software at the client's site. It requires onsite monitoring, especially when the customised software is developed. Hence, it cannot be equated with the commodities, where the role of a commission agent normally ends after supply of goods and receipt of money.

iii) In the present case, the commission agent has vast technical knowledge and experience. Further, he is also one of the directors of the assessee. He is able to secure orders only because of his vast technical knowledge and experience.

iv) As per the clauses of the agreement, the commission agent is responsible in securing orders and for that purpose he has to assist the assessee in all respects including identifying markets, making introductory contacts, arranging meeting with prospective clients, assisting in preparation of presentations for target clients.

v) The commission agent's duty does not end on securing the orders, but he has to monitor the status and progress of the project, meaning thereby, the commission agent is responsible for ensuring supply of the software and also for receiving the payments. All these activities could be carried on only by a person who has vast technical knowledge and experience. Accordingly, the payment made to a commission agent constitutes towards technical services.

vi) The commission agent was the director of the company and also the sole foreign marketing agent. Hence, he has got responsibility to take care of business interests of the assessee. Hence, the office of the assessee can be treated as the fixed base of the commission agent, as per Article 14 – Independent Personal Services of the tax treaty.

vii) As a director, he has every right to look into and is required to take care of the affairs of the assessee. Hence, the office of the assessee can be treated as fixed base for the commission agent. The certificate/

affidavit given by the assessee was not of any help due to the closeness of the non-resident director with the assessee.

viii) The assessee would be liable to deduct tax on the payments made to a commission agent. Since tax has not been deducted under section 195 of the Act, the payment was disallowed under section 40(a)(i) of the Act.

II. Transfer Pricing – Corporate Guarantee Commission in respect of Bank Loans and LC Facilities available by AEs – Bank Guarantees and Corporate Guarantees distinguished – Naked bank quotes not good external CUPs – Tribunal upholds guarantee commission charged on loans and letter of credit facility at 0.53 per cent and 1.47 per cent respectively as arm's length

Glenmark Pharmaceuticals Limited vs. ACIT [TS-329-ITAT-2013 (Mum)-TP] – Assessment Year: 2008-09

Facts

1. The assessee is engaged in the business of manufacturing and marketing of pharmaceutical products and related Research and Development activities.

2. During the year under consideration, the assessee had charged guarantee commission of 0.53% and 1.47% in respect of guarantee provided in connection with bank loans and LC facilities availed by its Associated Enterprises (AEs); Glenmark Holding SA, Switzerland and Glenmark Generics SA, Argentina respectively. In the Transfer Pricing study (TP study) undertaken by the assessee, the guarantee commission charged of 0.53% for loan guaranteed and 1.47% for LC facility was determined to be at arm's length applying the Comparable Uncontrolled Price (CUP) method.

3. The Transfer Pricing Officer (TPO) rejected the TP study stating that the assessee failed to discharge its primary onus of benchmarking the transaction and determined arm's length guarantee commission at three percent of the guaranteed amount based on guarantee commission rates charged by various banks, i.e. Allahabad Bank (3 per cent per annum); Dutch State, FMO (2.5 per cent per annum); HSBC Ltd. (0.15 per cent to 3 per cent per annum); and EXIM Bank of USA (3 per cent per annum) resulting in an adjustment of INR 115.1 million.

4. The assessee filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)] against the above adjustment and submitted that following points should be considered while determining arm's length price of the assessee's guarantee commission: (a) Interest saving, (b) Adjustments towards negotiations, (c) Risk undertaken by the assessee while providing guarantee to the AEs, etc. The CIT(A) however, upheld the adjustment made by the TPO and determined the guarantee commission at 3 per cent as arm's length. Aggrieved by the order of CIT(A), the assessee filed an appeal before the Tribunal.

Decision

The Tribunal held in assessee's favour as follows:

1. There are conceptual differences between a bank guarantee and a corporate guarantee. In corporate guarantee, guarantee of payment is made by a corporation on behalf of another business entity. The guarantee is provided in consideration of a vendor providing credit to a business, on whose behalf the guarantee is made. Corporate guarantee operates not for business considerations, but to provide safeguards for the financial health of the AEs. Bank guarantee is a surety bond in finance, a promise by one party to assume responsibility for the debt obligation of a borrower if the borrower defaults. Commercial considerations are paramount in fixing charges in case of a bank guarantee. Hence, a bank guarantee comparable may not

clear the Functions, Assets and Risks (FAR) analysis test in case of a corporate guarantee.

2. Bank guarantee rates cannot be applied mechanically. These need to be adjusted for various factors, such as (a) risk profiles of the respondents for the guarantee, (b) financial position of the loan applicants, (c) terms of the guarantee, (d) securities involved, (e) quantum of guarantee, (f) amount involved, (g) period of guarantee, (h) past history of the customers, etc.

3. The ruling of Technimont ICB Ltd. is an aberration and the facts are distinguishable vis-à-vis assessee's case. The Tribunal has analysed various rulings like Asian Paints Ltd., Everest Kanto Cylinder Ltd., and Reliance Industries Ltd. on guarantee commission and concluded that the guarantee commission rates of 0.53 per cent and 1.47 per cent on loans and LC facility are at arm's length.

3. Taxation of FIIs – Whether loss on derivative transactions incurred by FIIs is in the nature of capital gains and not business income – Held: Yes – Section 115AD and Section 43(5) of the Income-tax Act, 1961

Platinum Asset Management Ltd., A/c Platinum Asia Fund vs. DDIT [TS-610-ITAT-2013(Mum.)] – Assessment Year: 2006-07

Facts

1. The assessees are the sub-accounts of the FII Platinum Asset Management Ltd., registered in Australia and operating in India, registered with the Securities and Exchange Board of India (SEBI). The assessees are involved in purchase and sale of securities in India and trading in derivatives.

2. For Assessment Year (AY) 2006-07, the assessees filed NIL return of income respectively and claimed carry forward of short-term capital loss after setting off losses from index derivative transactions against short-term and long-term capital gains respectively.

3. The Assessing Officer (AO) held that the loss arising from index derivative transactions were business losses and assessable under the head business income and could not be claimed as capital loss.

Accordingly, the AO taxed the capital gains earned by the assessees. The Commissioner of Income Tax (Appeals) upheld the AO's order.

Decision

The Tribunal held in favour of the assessee as under:

1. The decision of *CIT vs. Bharat R. Ruia (HUF) [2011] 337 ITR 452 (Bom.)* is not applicable in the present case.

2. The issue is squarely covered by the decision of Platinum Investment Management Ltd., A/c. Platinum International Fund that relied on LG Asian Plus Limited, wherein the following observations were made:

- On a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD of the Act, seen in the light of the Memorandum explaining the provisions of the Finance Bill, 1993, a FII is allowed to invest only in the `securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone.
- Once it is noticed that a FII can only 'invest' in `securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD of the Act, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short-term or long-term capital gains.
- If the tax authorities venture to make a distinction between such securities as constituting capital asset or stock-in-trade,

which is not contemplated by the Central Government, as is evident from SEBI (FII) Regulations and the definition of FII in Explanation (a) to section 115AD of the Act, then this provision will become otiose.

- If FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under section 115AD(1) of the Act alone and section 115AD(2)(b) of the Act cannot be invoked to construe it as `Business income'.
- From the earlier Press Note (F No. 5(13) SE/91-FIV dated 24th March, 1994 issued by Ministry of Finance, Department of Economic Affairs (Investment Division), New Delhi) issued by the Ministry of Finance, it is abundantly clear that FIIs have been considered as 'investors' (and not traders). Secondly, income from the transfer of securities has been viewed as chargeable to tax under the head 'Capital gain,' as long-term or short-term capital gain, depending upon the period for which such securities are held.
- It is noticed that section 115AD of the Act falls in Chapter XII of the Act which deals with determination of tax in certain special cases. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision.
- Further section 43(5) of the Act defining a 'speculative transaction' is relevant only in the context of income under the head `Profits and gains of business or profession'. It has no application to FIIs in respect of securities as defined in explanation to section 115AD of the Act, income from whose transfer is considered as short term or long-term capital gains.
- Income arising from the derivative transactions to the assessee, being a FII cannot be treated as business profit or loss, whether speculative or nonspeculative, but the same has to be capital gain or loss. Further, loss from derivative transactions is to be considered as short-term capital loss on sale of securities eligible for adjustment against short-term capital gains on sale of shares.

3. Following the decision of the Co-ordinate Bench of the Tribunal, the Tribunal held that income from derivative transactions in case of the assessees cannot be treated as business profit or loss.

"Health isn't about being "perfect" with food or exercise or herbs. Health is about nourishing your spirit as well as your body."

— *Golda Poretsky*

It is better to lose health like a spendthrift than to waste it like a miser.

— *Robert Louis Stevenson*

CA. Hasmukh Kamdar

INDIRECT TAXES

Central Excise and Customs – Case Law Update

CENVAT CREDIT

Commissioner of Central Excise Pune – II vs. Finolex Industries Ltd. [2013(298) ELT 52 (Tri. Mumbai)]

The brief facts of the case are as follows:

The manufacturer was engaged in the manufacture of excisable goods PVC Resin falling under Chapter 39 of the Tariff. CENVAT credit of CVD paid was availed on their imported raw materials i.e., Ethylene-Di-Chloride (EDC) and Ethylene.

It was noticed by the Department that there is difference in quantity of the imported goods as per Usage Report and storage tank outturn reports. Show cause notice was issued to the respondent denying credit on the ground that the manufacturer is not entitled for credit in respects of the quantity which were found to be short in the storage stock as the same is not used in relation to the manufacture of excisable goods.

The adjudicating authority confirmed the demand. However the Commissioner (Appeals) set aside the demand relying on the Tribunal decision in the case of the manufacturer himself. *[Finolex Industries Ltd. vs. Commissioner – 2003(156) ELT 96 (Tribunal)].*

The Revenue has preferred this appeal before the Hon'ble CESTAT.

On behalf of the Revenue it was contended that an appeal has been filed and pending before the Hon'ble High Court against the decision of the Tribunal relied upon by the Commissioner Hon'ble Tribunal observed as follows:

The Revenue has not produced any order passed by the Hon'ble High Court staying the operation of the order or setting aside the decision of the Tribunal by the Hon'ble High Court.

On merits it was found that during the period in dispute that total shortage comes to 0.08%. The goods in question are in liquid form and received through pipeline from getty in the factory. The quantity of the material is arrived by dip reading at storage tanks in the factory. The Hon'ble Rajasthan High Court in *Union of India vs. Bhilwara Spinning Ltd. reported in 2008 (222) E.L.T. 362 (Raj)* in respect of the quantity of HFO short received in the factory held that credit cannot be denied.

In that case, the Hon'ble High Court framed the following question of law and held as under.

> "Whether the MODVAT Credit is available to the assessee on the quantity of HFO short received in the factory and the same not used

in the manufacture of final product and also the assessee was liable for penalty under Section 11AC of the Central Excise Act, 1944 for the excess availment of MODVAT/CENVAT Credit during the period after 1-4-2000."

"Having considered the rival contentions, we are inclined to agree with the view taken by the Tribunal that in the facts and circumstances, when it is not in dispute that there is no diversion of the goods covered under the invoices in question and entire goods received under consignment has not been put to any use other than as input in the end product manufactured by the assessee and the transit loss was found by the Tribunal to be normal loss due to evaporation, it must be held that the CVD paid by the consigner/importer was paid in respect of the goods entire used by the assessee as inputs in the manufacture of end product.

Moreover, Rule 57(9) envisages that such amount of MODVAT credit availed by the assessee, which is evidenced by the invoices, has inherent co-relation with the payment of duty with goods covered by such invoices. Where the CVD, Customs or Excise duty on the inputs received by the assessee in the factory and used by him in manufacturing of end product has correlation with the evidence of the payment about the duty on the entire goods received and used in the factory, no curtailment of MODVAT credit as evidenced by the invoices is permissible. The mode of proof of quantity and payment of duty on inputs received and used as input is by producing the invoices. Unless the invoices are found to be wrong or diversion of inputs received under invoices to any other use is found, there is no provision to avail lesser MODVAT credit than what has been proved to have been paid on the entire goods received and used in factory of manufacturer.

The conclusion reached by the Tribunal is, therefore, justified and does not call for any interference."

In the present case, the Hon'ble Tribunal further observed that there is no allegation that the imported raw material has been diverted. In these circumstances, respectfully following the above decision of the Hon'ble Rajasthan High Court we find no merit on the appeal filed by the Revenue.

The Revenue Appeal was dismissed.

Manufacture & Clearances

Commissioner of Central Excise, Belgaum vs. Jindal Praxair Oxygen Co. (P) Ltd. [2013 (298) E.L.T. 136 (Tri. Bang.)]

Facts in this case are as follows

The assessee in this case was engaged in the manufacture of Oxygen, Nitrogen and Argon gases, which are normally cleared through pipeline to the consumer's factory. Due to technical reasons, release of some quantities of the gases to the atmosphere was inevitable. The Department wanted to levy duty of excise on these quantities of gases also. Show cause notices were issued for this purpose. Some of them happened to be adjudicated in favour of the assessee and the rest of the notices came to be adjudicated against them. Consequently, appeals came to be filed by both the assessee and the Department and all such appeals came to be disposed in favour of the assessee by the Commissioner (Appeals).

Aggrieved by order of the Commissioner (Appeals) holding in favour of the assessee Revenue has filed this Appeal to the Hon'ble CESTAT on the question whether duty of excise was leviable on Oxygen, Nitrogen and Argon gases vented out to the atmosphere during the period of disputes.

The Hon'ble Tribunal observed that the short issue arising for consideration is whether the gases vented out as above by the respondent during the period of dispute were exigible to duty of excise. On a perusal of the records, it was found that

the respondent was constrained, by the technology adopted by them for continuous manufacture of the gases, to allow some volume of the three gases to escape into the air to prevent damage of the pipeline due to accumulation of high pressure that might arise in the event of the consumer's inability to ensure steady consumption of the gases supplied by the respondent. After noting this factual situation unique to the manufacture of gaseous products like Oxygen, Nitrogen and Argon, this Bench, in the respondent's own case, held against leviability of excise duty on the gases which were vented out to the atmosphere in the aforesaid manner in the case of *Jindal Praxair Oxygen Co. Pvt. Ltd. vs. C.C.E, Belgaum [2007 (219) E.L.T. 722 (Tri-Bang.)].*

Para 6 of the cited decision reads as follows:

"6. On a careful consideration of the submissions made by both the sides, we notice from the impugned order that the appellants have relied on the Board's Circular No. 246/80/96-CX, dated 1-10-1996 which is reproduced hereinbelow:

"I am directed to refer to erstwhile Notification No. 75/94-C.E dated 1-3-1994. Gases falling under Chapter 27, 28 or 29 produced in a factory and allowed to escape in the atmosphere by flare system or otherwise were exempt from excise duty *vide* S. No. 14 of the Notification. The exemption was reviewed during the budget and it was felt that gases escaping into the atmosphere by flare system or otherwise may not be considered as 'manufactured' products and amounting to clearance and as such there may not be any need for prescribing separate exemption from the duty and hence the reference to the above mentioned exemption was deleted. Accordingly, it has been clarified in para 11.8 of Budget Instructions sent along with Commissioner (TR's D.O. letter No. 334/14/95, dated 23rd July, 1996 that gases falling under Chapter 27 produced in a factory and allowed to escape in the atmosphere by flare system or otherwise may not be considered as manufactured products and amounting to clearance (refer para 18.1 of instructions on Central Excise notifications issued in connection with Union Budget 1996-1997).

Para 11.8 of the Budget Instructions refers to goods falling under Chapter 27 and there is no reference to gases falling under Chapter's 28 or 29. In this context, a question has been raised whether on similar basis gases falling under Chapter's 28 or 29 produced in a factory and allowed to escape in the atmosphere are also not to be regarded as "manufacture". The answer to this lies in the affirmative. Accordingly, it is cleared that gases falling under Chapter 28 and 29 produced in a factory and allowed to escape in atmosphere are not liable to duty."

As per the above Board's Circular, gases which were vented out in the atmosphere are exempted from excise duty. The show cause notice admits the fact of venting out of the gases in the air. The Revenue has not produced any evidence that the appellants have collected any consideration of price for the gases which have been vented out in the atmosphere. The appellants have established that they have not received any consideration for the gases which have been vented out in the air. The Revenue is bound by the Board's Circular as held by the Apex Court in the case of Dhiren Chemical Industries. There is no merit in the impugned order. The appeal is allowed with consequential relief if any.

The Hon'ble Tribunal, following the cited decision, dismissed the appeal.

CA Janak Vaghani

INDIRECT TAXES
VAT Update

1. Trade Circular No. 1T of 2014 dated 4-1-2014 and 2T of 2014 dated 7-1-2014 – Due Date for Submission of VAT Audit Report for the Period 2012-13 – By Developers – Extension

The Commissioner of Sales Tax Maharashtra has issued circular No. 1T of 2014 dated 4-1-2014 and is modified further by circular No. 2T of 2014 dated 7-1-2014. whereby it is clarified that to give effect of the judgment of SC in case of MCHI rule 58(1) and (1A) is under progress and it will take some time.In view of above it is administratively decided that If, an audit report in Form 704, pertaining to the developer s other than those opting for composition scheme for the period 2012-13 is filed within one month from the due date i.e. on or before 15th February, 2014, then penalty under u/s 61(2) shall not be imposed.

2. Web site Updates – List of Reference/Appeal for Form 704

Under the amended Form 704 the VAT auditor is required to certify in clause (d) of part I about reference or appeal filed by the department against the judgment of Tribunal decided against the department. The list of such cases where appeal or reference is filed by the department is uploaded on the website for the said purpose.

"Today, more than 95% of all chronic disease is caused by food choice, toxic food ingredients, nutritional deficiencies and lack of physical exercise."

— *Mike Adams*

"The part can never be well unless the whole is well."

— *Plato*

CA. Rajkamal Shah & CA. Naresh Sheth

INDIRECT TAXES

Service Tax – Statute Update

Clarification on Voluntary Compliance Encouragement Scheme (VCES)

The Central Board of Central & Excise has issued certain directions on issues arising out of implementation of VCES by the department:

1. That the designated authority should not seek undertaking from the declarant that he had no unpaid tax dues for remaining period covered under the scheme. Form VCES – 1 itself includes the undertaking the information given in declaration is correct and complete.

2. That there is no bar on payments by installments so far as the condition of minimum payment of 50% of tax dues by 31-12-2013 is satisfied.

3. That as regards to verification of calculation of tax dues, the designated authority may only carry out only arithmetical check as regards to correction of computation of tax dues as the scheme does not envisage detailed investigation by such authority.

   (F. No. B1/19/2013-TRU dtd. 11-12-2013)

4. The CBEC has advised the Chief Commissioners to ensure that adequate arrangements are made for speedy processing of application under VCES. The time period of 30 days would not be available in case of applications made in December and therefore the declarations which are in order must be orally communicated so that 50% of tax dues are paid by 31-12-2013. The commissioners should also ensure that the rejections by the designated authority are strictly covered by the board clarifications dtd. 13-5-2013, 8-8-2013, 25-11-2013 and 6-11-2013.

   (F.No. 137/50/2013-Service Tax dtd. 2-12-2013)

> Healthy people are those who live in healthy homes on a healthy diet
>
> — *Ivan Illich*

CA. Bharat Shemlani

INDIRECT TAXES

Service Tax – Case Law Update

1. Services

Maintenance and Repair Service

1.1 CC&CE, vs. Balaji Tirupati Enterprises 2013 (32) STR 530 (All.)

The High Court in this case held that goods used during repair service are goods deemed to be sold in execution of works contract and therefore not in purview of levy of service tax.

1.2 Jagat Machinery Manufacturers P. Ltd. vs. CCE, Ghaziabad 2013 (32) STR 663 (Tri-Del.)

The appellant in this case, undertook job work of deshelling, reshelling and further processing of old and worn out sugar mill rollers and the period involved was July, 2003 to February, 2006. The department confirmed demand under Maintenance or Repair service. The Tribunal held that definition of maintenance or repair service amended w.e.f. 16-6-2005 and prior to 16-6-2005 it does not cover reconditioning and restoration service and said activity was liable to service tax w.e.f. 16-6-2005.

1.3 Hindustan Aeronautics Ltd. vs. CST, Bengaluru 2013 (32) STR 783 (Tri-LB)

The appellant in this case claimed exclusion of cost of goods sold or deemed to have been sold to service recipient. The department contended that benefit of Notification No. 12/2003-ST is confined to sale of goods, excluding 'deemed sale'. The Tribunal observed that precedent decisions found to limit scope of section 67 of FA, 1994 only to ascertain value of service component, wherever complex transactions involving service and sale element including deemed sale were presented for valuation of transaction as taxable service. It is also observed that, jural basis of Larger Bench decision in *Aggarwal Colour Advance Photo System 2011 (23) STR 608 (Tri-LB)* was eclipsed by binding authority of other decisions of Supreme Court and Delhi High Court. In view thereof it is held that, as core dispute was settled by higher authority of Supreme Court and Delhi High Court, there was no need for Larger Bench to decide issued referred for its consideration and it is to be decided by regular Bench.

Clearing & Forwarding Agent's Service

1.4 CST, Mumbai vs. Shah Coal Pvt. Ltd. 2013 (32) STR 568 (Tri-Mumbai)

The department sought to demand tax on supervision of loading and transportation of coal by road under Clearing & Forwarding Agent Service. The Tribunal held that section 65(25) of FA, 1994 does not define or describe 'Clearing and Forwarding operations'. The Board Circular No. B-43/7/97-TRU, dated 11-7-1997 clearly specify functions undertaken by C&F Agent in normal course of business. The said circular was issued at the time of inception of levy to be given weightage in view of principles of 'administrative construction' of statute.

1.5 Karamchand Thapar & Bros. (Coal Sales) Ltd. vs. CST Kolkata. 2013 (32) STR 568 (Tri-Kolkata)

In this case, the appellant was appointed by clients to supervise and involve in movement of allotted quantity and quality of coal from collieries to their premises for its consumption, without interruption and delay and remuneration for such movement

was fixed in accordance with quantity of coal received by principal at place of its consumption. The Tribunal held that it was not service of mere loading of coal in railway wagons by collieries and its automatic onward movement to pre-determined destination for consumption. The appellant was required to ascertain correct quality and quantity of coal through strict supervision before or at time of its loading in railway wagons, which indicated that they had requisite authority as agent for their principal to receive only agreed quantity of coal and reject coal which is not conforming to specifications. Though destination was already fixed, but all related services till coal reached its destination was rendered by appellant. Hence, services rendered by the appellant were connected with C&F operations and therefore liable to service tax.

It is held that, it is not necessary to undertake all activities/services narrated in Mumbai Commissionerate Trade Notice No. 8/97-ST. The activities/services mentioned in CBEC Circular No B/43/7/97-TRU dated 11-7-1997 are only illustrative in nature and not exhaustive. If person undertakes activities/renders services, not mentioned in aforesaid list of services, but satisfies all ingredients of definition of C&F Agent then he would fall within its scope.

Freight financing charges collected from customers includes services connected with C&F operations and therefore liable to service tax.

As per section 66 of FA, 1994 service tax is chargeable on value of taxable service received by assessee. Assessee's registered office was at Kolkata, where their profit/loss account and balance sheet had been prepared on trial balance from respective branch offices. Hence there was centralised accounting system at Kolkata and Commissioner at Kolkata had jurisdiction to decide issue of non-payment of service tax on taxable value received by assessee for services rendered through various branches. Rules 4(2) and (3A) of STR, 1994 are designed for convenience of taxpayers, for easy administration of FA, 1994 and to avoid overlapping of jurisdiction and conflicting views in assessment of service tax of same assessee rendering services from different locations.

Construction Service

1.6 G. D. Builders vs. UOI 2013 (32) STR 673 (Del.)

The High Court in this case held as under:

- The scope and ambit of Commercial or Industrial and Residential construction service cannot be read down on imposition of service tax on works contract, which covers contractor only supplying labour or undertaking construction service, whether with or without supply of material. The levy under construction services is valid, the only condition being that it should be on service element and not on materials or goods used, as power to levy Sales Tax or VAT is with State Government.
- After 46th amendment to Constitution of India composite contracts can be bifurcated to compute the value of goods sold/supplied in contracts for construction of building with labour and material. Service portion of composite contracts can be subjected to Service Tax. Aspect doctrine can be applied for bifurcating/vivisecting the composite contract.
- Notification providing for 67% abatement towards value of material used for computing service tax payable is to ensure that service element is taxable. It is alternative to otherwise subjective determination in each case, which may be cumbersome and require detailed examination for ascertainment of service element. It provides convenient, alternative, optional and hassle free method for exclusion of non-service element and payment of service tax provided requirements mentioned in the notification are satisfied.
- Service tax can be levied on service element. Computation of this component is matter of detail and not relating to validity of imposition of service tax. It is procedural and matter of calculation and merely because no rules are framed for computation, it does not follow that no tax is leviable.

Erection, Commissioning or Installation Service

1.7 Suvidha Engineers India Ltd. vs. CCE, Noida 2013 (32) STR 735 (Tri-Del.)

The appellant undertook and executed various turnkey projects which included activities of fabrication, installation and commissioning during period 1-7-2003 to 15-6-2005. The department

demanded service tax under ECI service. The appellant contended that their activities brought under definition of Section 65(39a)(ii)(c) in relation to heating, ventilation, or air-conditioning w.e.f. 16-6-2005. The Tribunal held that, installation of plant, machinery or equipment covered in the definition from very beginning and it is very difficult to distinguish that heating system, ventilation system, and AC system is different from heating plant etc. and therefore activities of the appellant are taxable prior to 16-6-2005. It is further held that since appellant submitted monthwise details of payment received on 5-9-2005, the department was free to issue SCN within one year after details of value of taxable service was made available and there is no reason to invoke extended period of limitation.

Site Formation and Clearance, Excavation and Earth Moving and Demolition Service

1.8 Karamjeet Singh & Co. Ltd. vs. CCE, Raipur 2013 (32) STR 740 (Tri-Del.)

In this case the issue was regarding the value of diesel supplied by service recipient free of cost to assessee includible in gross amount for charging service tax. The Tribunal after relying on Delhi High Court decision in *Intercontinental Consultants & Technocrats Pvt. Ltd. 2013 (29) STR 9 (Del.)* held that rule 5(1) of Valuation Rules, 2006 is invalid and *ultra vires* the provisions of section 67 of FA, 1994. In view thereof, value of diesel supplied free of cost by service recipient to assessee for providing taxable service would not be a component of the gross value charged for service provided for computation of tax under section 67.

2. Interest/Penalties/Others

2.1 Vihar Aahar Pvt. Ltd. vs. CST, Ahmedabad 2013 (32) STR 563 (Tri-Ahmd.)

The department in this case, confirmed demand falling within jurisdiction of various other Commissionerates. The Tribunal held that, in absence of Notification or Board Circular authorising/directing Commissioner Ahmedabad-I to issue SCN and adjudicate demand for services rendered at Mumbai, Karnataka and Kanpur, the jurisdiction exercised for confirming demand is beyond jurisdiction.

2.2 Eastern Shipping Agency vs. CST, Ahmedabad 2013 (32) STR 630 (Tri-Ahmd.)

The appellant in this case filed refund claim subsequent to Order-in-Appeal reducing the appellant's tax liability. The Tribunal held that First Appellate Authority's finding that payment not shown as 'receivables' in balance sheet is not in consonance with *Modi Oil & General Mills 2007 (210) ELT 342 (P&H)* and not to carry Revenue's case further. It is observed that Chartered Accountant certificate categorically certifying verification of books of account and upon verification amount certified to have not been passed to clients. The decision of *Crane Betel Nut Powder Works 2010 (251) ELT 118 (Tribunal)* and *Mangal Textiles Mills Pvt. Ltd. 2004 (171) ELT 160 (Guj.)* are directly applicable as CA certificate was undisputed.

2.3 WNS Global Services Pvt. Ltd. vs. CCE, Nashik 2013 (32) STR 657 (Tri-Mumbai)

In the present case, refund claim was rejected on the ground that service provided by telecom authorities by leasing of telecom lines not eligible as input service. The Tribunal held that exports undertaken electronically through dedicated lines from office premises to telecom authorities and without dedicated lines, the appellant cannot deliver output service, therefore leasing of telecom lines by telecom authorities is input service. It is further held that prior to 2006 there was no requirement for registration. If nexus can be established between input service and output service, the appellant is entitled for credit.

2.4 Kijiji (India) Pvt. Ltd. vs. CCE, Mumbai-I 2013 (32) STR 661 (Tri-Mumbai)

In this case, the appellant claimed refund of input service credit on office utilities, infrastructure support service for running office, chartered accountants service, management consultancy service, insurance auxiliary service, advertisement service and professional services. The department rejected refund on the ground that there is no direct nexus between input services received and output service rendered. The Tribunal held that, all the services are essential in running business of rendering of output service "BAS" and appellant has rightly entitled for refund of service tax paid on such services.

2.5 Havels India Ltd. vs. CCE, New Delhi 2013 (32) STR 668 (Tri-Del.)

The appellant in this case claimed refund under Notification No. 17/2009-ST in respect of exports made prior to issuance of such Notification. The Tribunal observed that CBEC Circular No. 354/256/2009-TRU dated 1-1-2010 clarified that new notification does not bar exports prior to issuance

of Notification therefore scheme under Notification No. 17/2009-ST is applicable.

2.6 Kingfisher Airlines Ltd. vs. CST, Mumbai-I 2013 (32) STR 744 (Tri-Mumbai)

The department in this case provisionally attached 10 aircrafts belonging to assessee against default in payment of service tax dues. The Tribunal held that only orders passed under section 73 or 83 of FA, 1994 adjudging service tax liability or penalty are appealable before Tribunal. Section 73C does not empower officers to determine service tax liability or penalty and order passed thereunder is not appealable to Tribunal.

3. CENVAT Credit

3.1 Deepak Fertilizers & Petrochemicals Corpn. Ltd. vs. CCE, Belapur 2013 (32) STR 532 (Bom.)

The High Court in this case held that use of 'directly or indirectly' and 'in or in relation to' in the definition of Input Service are words of width and amplitude. The inclusive definition in rule 2(l) of CCR, 2004 is not restricted to input services used only for procurement and inward transportation of inputs. Input services utilised in relation to installation of ammonia storage tanks situated outside factory of production are admissible as input service.

3.2 Rajdhani Crafts vs. CCE, Jaipur 2013 (32) STR 607 (Tri-Del.)

The Tribunal in this case allowed CENVAT credit of service tax paid on transport of goods from factory to port, CHA service and terminal handling charges and similar other charges incurred within port area.

3.3 Aircel Cellular Ltd. vs. CST, Chennai 2013 (32) STR 618 (Tri-Chennai)

The appellant a mobile telecom operator has taken services of BSNL for connecting their customers to other persons located in areas by landlines of BSNL and claimed credit of service tax paid to BSNL. The Tribunal held that BSNL did not provide mere facility it was telecom service which was required by operator for providing output services to their customers and hence input service under rule 2(l) of CCR, 2004.

3.4 Nirma Ltd. vs. CCE&ST, Vadodara-I 2013 (32) STR 622 (Tri-Ahmd.)

The Tribunal in this case allowed CENVAT credit of service tax paid on pest control service, services for maintaining garden in factory premises and for construction of compound wall in view of the fact that the appellant was under obligation to maintain 33% of green area to mitigate effects of pollution as per direction of Ministry of Environment and Forests. Further, the construction of compound wall are input service as such construction is essential to demarcate registered factory premises and for protection of goods from pilferage and potential clandestine removal.

3.5 IFB Industries Ltd. vs. CCE, Bengaluru 2013 (32) STR 650 (Tri-Bang.)

The Tribunal in this case held that, outdoor catering service has nexus with manufacturing activity when it is provided by manufacturer in discharge of statutory obligation under section 46 of Factories Act, 1948 and it is factored into cost of production of final product. On facts of the present case, appellant has employed less than 250 workers during the period in dispute, they did not have statutory obligation to provide canteen service and hence it was not input service eligible for taking CENVAT credit.

CENVAT credit of service tax paid on repairs/ maintenance of guest house is not admissible in absence of nexus with manufacturing activity.

3.6 Nectar Lifesciences Ltd. (Unit-I) vs. CCE, Chandigarh 2013 (32) STR 659 (Tri-Del.)

The Tribunal in this case held that, dismantling of plant is not input service resulting in any tangible output or intimately connected with manufacture and therefore CENVAT credit availed thereon is recoverable. Further, service tax paid on installation charges of door is not input service when door not proved to be capital goods under Central Excise Tariff.

3.7 Meghmani Dyes & Intermediates Ltd. vs. CCE, Ahmedabad 2013 (32) STR 671 (Tri-Ahmd.)

The Tribunal in this case allowed CENVAT credit of service tax paid on bank charges paid in relation to purchase of raw material and sale of finished goods as same are relatable to manufacture of final products.

3.8 CCE, Tirupathi vs. India Cements Ltd. 2013 (32) STR 672 (Tri-Bang.)

The Tribunal in this case allowed service tax paid on insurance premium, though paid by contractor as insurance of labourers being essential for smooth functioning and amount of premium reimbursed by the manufacturer from part of cost of cement.

CA. Mayur Nayak, CA. Natwar Thakrar &
CA. Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed recent amendments to FEMA through RBI Notifications/Circulars and advisory issued by RBI through a Press Release:

A. RBI CIRCULARS

1. ECB by holding Cos./Core Investment Cos. for the project use in SPVs

In further relaxation of the ECB guidelines prescribed *vide* AP Dir Circular No. 5 dated 1st August, 2005 and amended from time to time, RBI has now permitted Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework of the Reserve Bank to raise ECB under the automatic route/ approval route for project use in Special Purpose Vehicles (SPVs) with the following terms and conditions:

i. The business activity of the SPV should be in the infrastructure sector where "infrastructure" is defined as per the extant ECB guidelines;

ii. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project;

iii. The ECB proceeds is utilised either for fresh capital expenditure (capex) or for refinancing of existing Rupee loans (under the approval route) availed of from the domestic banking system for capex as per the extant norms on refinancing;

iv. The ECB for SPV can be raised up to 3 years after the Commercial Operations Date of the SPV;

v. The SPV should give an undertaking that no other method of funding, such as, trade credit (if for import of capital goods), etc. will be utilised for that portion of fresh capital expenditure financed through ECB proceeds;

vi. The ECB proceeds should be kept in a separate escrow account as per the extant guidelines on parking of ECB proceeds pending utilisation for permissible end-uses and use of such proceeds should be strictly monitored by the ADs for permissible uses;

vii. In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the additional terms and conditions for raising ECB for project use in SPVs will be as under:-

a. The ECB availed is within the ceiling of leverage stipulated for CICs, i.e., their outside liabilities including ECB cannot be more than 2.5 times of their adjusted net worth as on the date of the last audited balance sheet; and

b. In case of CICs with asset size below ` 100 crore, the ECB availed of should be on fully hedged basis.

(A.P. (DIR Series) Circular No. 78 dated 3rd December, 2013)

(In the infrastructure development industry, FDI is either invited into specific SPV formed for each project or into the holding company if the foreign investor wants an exposure to a portfolio of infrastructure assets. In sync with the industry model, this move would allow ECBs to be raised by Holding Companies rather than by different SPVs individually. Another peculiar point to be noted in *this circular is that RBI has specified the time limit for raising of ECB for the first time.)*

2. Exim Banks line of credit of USD 30.94 million to the Govt. of Lao People's Democratic Republic

The Credit Agreement under the LOC is effective from November 26, 2013 and the date of execution of Agreement is September 9, 2013.

(A.P. (DIR Series) Circular No. 79 dated 6th December, 2013)

3. Deferred Payment Protocols dated April 30, 1981 and December 23, 1985 between Government of India and erstwhile USSR

In terms of AP Dir. Circular 76 dated 22nd October, 2013, the Rupee value of the Special Currency Basket was indicated as ` 83.819978 effective from November 18, 2013.

Upon revision on December 9, 2013, the Rupee value of the Special Currency Basket has been fixed at ` 83.564155 with effect from December 12, 2013.

(A.P. (DIR Series) Circular No. 80 dated 16th December, 2013)

4. Investments by persons resident outside India in the tax free, secured, redeemable, non-convertible bonds – Use of borrowed funds

Regulation No. 6 (2) of FEMA Notification No. FEMA 4/2000 [Foreign Exchange Management (Borrowing and Lending in Rupees)] imposes restrictions on person resident in India who have borrowed in Rupees from a person resident outside India to the effect that such borrowed funds cannot be used for any investment, whether by way of capital or otherwise, in any company or partnership firm or proprietorship concern or any entity, whether incorporated or not, or for relending.

In a move to relax the above restrictions, RBI has allowed resident entities/companies in India which have issued tax-free, secured, redeemable, non-convertible bonds in rupees to persons resident outside India to use such borrowed funds for following purposes:

c. lending/re-lending to the infrastructure sector; and

d. keeping in fixed deposits with banks in India pending utilisation by them for permissible end-uses.

(A.P. (DIR Series) Circular No. 81 dated 16th December, 2013)

(There have been several previous instances of issuance of tax free bonds to non-residents, particularly, FIIs, QFIs, NRIs. In the Shelf Prospectus for such bonds, resident entities (such *as PFC, REC) have specifically disclosed utilization* ***of issue proceeds towards lending operations of the company and interim deployment of funds in liquid instruments under 'Objects of the Issue'. Further, they have also noted compliance with FEMA***

Notification 4/2000 in the Shelf Prospectus implicitly ***acknowledging that neither amounts to 'investment' or 'relending'. Under such circumstances, the intention of issuance of this circular remains unclear and further puts in doubt interim deployment of*** *funds in liquid instruments other than fixed deposits* ***with banks.)***

5. Import of Gold by Nominated Banks/Agencies/Entities

Recently, RBI *vide* A.P. (DIR Series) Circular No. 25 dated August 14, 2013 and A.P. (DIR Series) Circular No. 73 dated November 11, 2013 has imposed restrictions on import of gold with a view to contain Current Account Deficit (CAD).

Since then, Government of India and the Reserve Bank of India have been receiving representations related to import of gold dore. Taking into account these representations and in consultation with the Government of India, RBI has issued the following clarifications which shall come into force with immediate effect :

a. Refineries are allowed to import dore up to 15% of their gross average viable quantity based on their licence entitlement in the first two months for making this available to the exporters on First in First out (FIFO) basis. Subsequent to this, the quantum of gold dore to be imported should be determined lot-wise on the basis of export performance.

b. Before the next import, not more than 80% shall be allowed to be sold domestically.

c. The dore so imported shall be refined and shall be released based on FIFO basis following 20:80 principle. This would be monitored by CBEC as earlier.

d. The imports, thereafter, shall be allowed only up to 5 times the quantum for which proof of export has been submitted. This shall be on accrual basis.

(A.P. (DIR Series) Circular No. 82 dated 31st December, 2013)

(This is a welcome relaxation by the RBI to allow import of gold dore into India. It should also help reduce unauthorised import of gold into India as has been reported recently in press reports.)

B. RBI PRESS RELEASE

1. RBI cautions users of Virtual Currencies against Risks

RBI has issued an advisory to users, holders and traders of Virtual Currencies (VCs) including Bitcoins explaining exposure the potential financial, operational, legal, customer protection and security related risks.

It has categorically stated that creation, trading or usage of VCs including Bitcoins, as a medium for payment are not authorised by it or any other central bank or monetary authority and that further, no regulatory approvals, registration or authorisation is stated to have been obtained by the entities concerned for carrying on such activities.

It has also stated that it is presently examining the issues associated with the usage, holding and trading of VCs under the extant legal and regulatory framework of the country, including Foreign Exchange and Payment Systems laws and regulations.

(Press Release: 2013-2014/1261)

(With the media hype around Bitcoin trading and the surge in its value, RBI has made its stand clear on this issue.)

Ajay Singh & Suchitra Kamble, *Advocates*

BEST OF THE REST

1. Interest that may be sold – Unpartitioned/Undivided share in joint property prior to partition, held, can be sold by joint holder thereof, and can be further sold by transferee of such unpartitioned share : Transfer of Property Act, 1882 – Ss. 54, 5, 6 and 8

The respondent – plaintiff while in joint holding, sold the suit land, being his share, without specifying the khasra numbers to Defendants 1 to 4 and delivered possession of two parcels of land to them, who in turn sold the land in pieces to Defendants 5 to 8 (the appellants) but specifying khasra numbers and mutation numbers and delivered possession of the same parcels of land to the appellants. The respondent filed a suit for declaration and possession of the suit land and permanent injunction restraining the appellants from alienating the same or raising any construction thereon on ground that he having sold the suit land to Defendants 1 to 4 without specifying khasra numbers, those defendants became out of the joint holding, they had no right to sell specific pieces of land with khasra numbers. The trial court held that since the appellants purchased land from Defendants 1 to 4 to whom the plaintiff had himself delivered possession at the time of execution of the sale deed, the plaintiff was not entitled to any relief. The respondent's First Appeal before the District Judge was dismissed. In Second Appeal, the High Court after framing a substantial question of law as to whether the courts below failed to consider material evidence, made its own assessment of the entire evidence and held that the plaintiff was the owner of the suit land and was also entitled to relief sought by him.

Allowing the appeal and restoring the decree of the first appellate court dismissing the respondent-plaintiff's suits, the Supreme Court held that the appellants were in lawful possession of the said areas of land by virtue of the sale deeds executed by the respondent-plaintiff in favour of Defendants 1 to 4, who in turn had executed valid sale deeds in favour of the appellants, and thus the plaintiff had not been able to establish that he was the owner of the suit land and consequently that he is entitled to declaration of his title, recovery of possession and injunction. Possession of the appellants would continue as before but would be liable to be changed as and when any partition proceedings is effected between the co-sharers. In the present case, the core issue was whether the respondent – plaintiff was the owner of the suit property and the first appellate court has rightly held that the plaintiff has not been able to prove his ownership over the suit property. In this case, therefore, the first appellate court had decided the core issue against the plaintiff and no substantial question of law arose for decision in this case by the High Court under Section 100 CPC.

Nasib Kaur and Ors. vs. Col. Surat Singh (Deceased) through lrs. & Ors. (2013) 5 SCC 218

2. Daily wage worker – Wrongful termination of service – Relief – Compensation and not reinstatement. : Industrial Disputes Act, 1947 – Ss. 25-F and 11-A

The respondent was engaged as a daily wager and worked for 240 days continuously in the year preceding the date of termination. The Labour Court awarded reinstatement with continuity of service and 25% of back wages. The question was where the workman had worked for only eight months as daily wager and his termination has been held to be in contravention of Section 25-F of the Industrial Disputes Act, 1947, whether the direction to the employer for reinstatement with continuity of service and 25% back wages is legally sustainable?

The Hon'ble Court observed that although an order of retrenchment passed in violation of Section 25-F of the Industrial Disputes Act may be set aside but an award of reinstatement should not be passed. The Supreme Court had distinguished between a daily wager who does not hold a post and a permanent employee.

The Supreme Court held that before exercising its judicial discretion under Section 11-A of the Industrial Disputes Act, the Labour Court has to keep in view all relevant factors, including the mode and manner of appointment, nature of employment, length of service, the ground on which the termination has been set aside and the delay in raising the industrial dispute before grant of relief in an industrial dispute. A distinction has been drawn between a daily wager and an employee holding the regular post for the purposes of consequential relief. In case of wrongful termination of a daily wager who had worked for a short period, the award of reinstatement cannot be said to be proper relief and rather award of compensation in such cases would be in consonance with the demand of justice.

Assistant Engineer, Rajasthan Development Corporation and Anr. vs. Gitam Singh (2013) 5 SCC 136

3. Usufructuary mortgage – Suit redemption – Cause of action for filing suit accrues at time when mortgage money is offered by mortgagor – Mortgagee refused or ignored to accept same – Suit for redemption filed after lapse of 30 years from that date – Barred by limitation - Transfer of Property Act, 1882, Ss. 58(d), 60, 62 – Limitation Act, 1963, Sch. Article 61(a)

The revision petition under Section 115, CPC had been filed by the defendants aggrieved against the order passed by Civil Judge whereby, the petitioner's application under Order VII, Rule 11(d), CPC was rejected. While allowing the Revision the High Court held that Sections 58(d) defines usufructuary mortgage and the terms of the mortgage deed; Section 60 provides that at any time after the principal money has become due, the mortgagor has a right, on payment or tender, at a proper time and place, of the mortgage money, to require the mortgagee to deliver the documents, possession, etc. provided that the right conferred by the said Section has not been extinguished by act of the parties or by decree of a Court; Section 62 deals with the specific right of the usufructuary mortgagor to recover the possession on the events indicated therein. The Limitation Act provides for filing a suit by a mortgagor to redeem or recover the possession of immovable property as 30 years and 'time from which the period begins to run' is provided as 'when the right to redeem or to recover possession accrues.' Combined reading of the said provisions reveal that in case no period as such is prescribed in a usufructuary mortgage, the mortgagee is under an obligation to put back the mortgaged property, the moment the mortgage money has been paid back or it has otherwise been settled. If the mortgagee refuses to do so, the only option left to the mortgagor is to institute a suit for redemption and recovery of possession.

Mohan Lal & Ors. vs. Mohan Lal AIR 2013 Rajasthan 187

4. Devolution of Coparcenary property – Suit for partition – Dismissal – Order dismissing suit for partition treating plaintiff's father property as self acquired property not proper. Hindu Succession Act, 1956, Ss. 6, 8

The plaintiff was born on 25-3-1982. Plaintiff's father i.e. defendant No.2 executed two

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separate sale deed in 19-2-2000 and release deed 28-5-2004.

The plaintiff appellant case is that at the time when plaintiff's father got the properly in partition, it was his separate property vis-à-vis his relations but after the birth of the plaintiff, plaintiff acquired interest in the property as a coparcener.

It was the case of the plaintiff that the property received by his father is ancestral property and alienation of the same by him is null and void. On the basis of the aforesaid pleadings, the plaintiff prayed for declaration that the release deed, sale deeds and the mutation entries made on that basis are illegal, null and void and not binding on him. The trial Court came to the conclusion that the property which defendant No. 2 got by virtue of the partition decree amongst his father and brothers was although separate property *qua* other relations but it attained the characteristics of coparcenery property after the plaintiff was born. Accordingly, the trial court decreed the suit. The High Court confirmed the decree.

The Supreme Court while allowing appeal held that Coparcenary property means the property which consists of ancestral property and a coparcener would mean a person who shares equally with others in inheritance in the estate of common ancestor. Coparcenary is a narrower body than the Joint Hindu Family and before commencement of Hindu Succession (Amendment) Act, 2005, only male members of the family used to acquire by birth an interest in the coparcenary property. A coparcener has no definite share in the coparcenary property but he has an undivided interest in it and one has to bear in mind that it enlarges by deaths and diminishes by births in the family. It is not static. So long, on partition an ancestral property remains in the hand of a single person, it has to be treated as a separate property and such a person shall be entitled to dispose of the coparcenary property treating it to be his separate property but if a son is subsequently born, the alienation made before the birth cannot be questioned. But, the moment a son is born, the property becomes a coparcenary property and the son would acquire interest in that and become a coparcener. A person, who for the time being is the sole surviving coparcener as in the present case the plaintiff's father was, before the birth of the plaintiff, was entitled to dispose of the coparcenary property as if it were his separate property. Plaintiff's father, till the birth of plaintiff, was competent to sell, mortgage and deal with the property as his property in the manner he liked. Had he done so before the birth of plaintiff, he was not competent to object to the alienation made by his father before he was born or begotten. But, in the present case, it is an admitted position that the property which defendant No. 2 got on partition was an ancestral property and till the birth of the plaintiff he was sole surviving coparcener but the moment plaintiff was born, he got a share in the father's property and became a coparcener. As observed earlier, in view of the settled legal position, the property in the hands of defendant No. 2 allotted to him in partition was a separate property till the birth of the plaintiff and, therefore, after his birth defendant No. 2 could have alienated the property only as Karta for legal necessity. It is nobody's case that defendant No. 2 executed the sale deeds and release deed as Karta for any legal necessity. Hence, the sale deeds and the release deed executed by the plaintiff's father to the extent of entire coparcenary property are illegal, null and void. However, in respect of the property which would have fallen in the share of plaintiff's father at the time of execution of sale deeds and release deed, the parties can work out their remedies in appropriate proceeding.

Rohit Chauhan vs. Surinder Singh & Ors. AIR 2013 SC 3525

5. Consumer Protection – Builder : Complaint – Non-delivery of flat – *Mala fide* intention from date of execution of agreement proved – Compensation equivalent to flat value

Respondent/Complainant filed a Consumer Complaint before the Consumer Disputes Redressal Forum, Mumbai on the allegations that petitioner-firm who is Builder/Developer decided to construct buildings and respondent agreed to purchase a flat admeasuring about 885 sq. ft. in built-up area in the Scheme – 'Highland Project', for an agreed consideration of ` 10,62,000/-. The Petitioner

executed a registered agreement for sale to that effect in favour of the respondent on 8-10-2001. Respondent paid booking amount of ` 10,000/-. Thereafter, paid an amount of ` 3,83,114/- in cash for which petitioner issued a receipt in writing. Possession of the flat was agreed to be delivered to the respondent as early as possible. It is alleged that the construction work was stopped by the petitioner and there has been no progress of construction on account of which, there has been delay in delivery of possession of the flat by the petitioner to the respondent.

Thereafter, respondent sent a legal notice dated 10-5-2007 to the petitioner and when that notice was also not complied with, respondent filed a complaint before the Consumer Forum seeking direction against the petitioner, to deliver vacant and peaceful possession of the flat in question besides payment of compensation or in the alternative to direct the petitioner to pay the cost of the flat, that is, ` 10,62,000/- together with interest @ 24% p.a., on the amount in sum of ` 3,93,114/- which was received by the petitioner from the respondent towards part-consideration for the said flat. Aaccording to the petitioner, unless the FSI is regularised, the work of the said project cannot be completed. Thus, petitioner has denied allegations that it is guilty of deficiency in service and has denied the allegations as regards its liability to pay compensation to the respondent.

Consumer Forum, *vide* order dated 7-10-2010 allowed the complaint and directed the Opposite Party to pay to the complainant interest @ 18% p.a., on the amount of ` 3,93,114/- as from 8-10-2001 till 19-3-2008. Further, the Opposite Party shall also pay to the complainant, an amount in sum of ` 10,62,000/- by way of compensation and further directed to pay to the complainant, costs in sum of ` 10,000/-.

The State Commission, dismissed the appeal of the petitioner.

The Hon'ble National Commission observed that it is not in dispute that an agreement for sale of the flat in question was executed between the parties on 8-10-2011. However, for the reasons best known to the petitioner, it has deliberately left the date of handing over of the possession of flat in question to the respondent, as blank. This clearly shows that the date of handing over of possession to the respondent was mischievously left blank.

Further, the *mala fide* intentions of the petitioner in misrepresenting the respondent about the status of various so called sanctions obtained for the purpose of flat in question, are writ large from day one. Agreement for sale was executed on 8-10-2001, but petitioner had no permission under the Maharashtra Regional & Town Planning Act, 1966.

Thus, petitioner from day one, that is from the date of the execution of agreement, had the *mala fide* intention to grab the hard earned money of the respondent. Admittedly, petitioner had been enjoying the money of the respondent for the last more than two years. Further, even after getting two adverse finding from the fora below, petitioner is in no mood to refund the lawful money deposited by the respondent. Furthermore, a crucial fact observed by the State Commission, is that builder has sold the said flat at ` 55 lakhs and he is simply required to pay a sum of ` 10 lakhs and some amount to the original complainant (flat purchaser). The findings of the State Commission speaks volume about the ulterior motive and *mala fide* intentions on the part of the petitioner. The question which arose for consideration was as to what should be the quantum of the damages which should be imposed upon the petitioner for trying to drag the respondent up to this fora, when petitioner had no case at all. The Commission dismissed the revision petition with cost of ` 50,000/-, (Rupees Fifty Thousand only. The order of the Consumer Form was upheld.

Further, the petitioner was directed to deposit the cost by way of demand draft in the name of 'Consumer Legal Aid Account' of the Commission within six weeks.

M/s. Vora Land Developers vs. Mr. Jayantilal Hirji (NCDRC New Delhi), Revision Petition No. 1596 of 2012, dated 16-12-2013.

CA. Rajaram Ajgaonkar

ECONOMY AND FINANCE

RECEDING FEARS

The world economy continued its progress in the month of December, 2013 and the calendar year has ended on a positive note. The fear of tapering by the US was real and it substantially haunted the global investors over the past few months. The improved data from the US made it imperative that tapering will start, but nobody was certain as to when and how aggressively it will start. However, the recent announcement from FED was a positive development for the world which was on tenterhooks. The decision of FED to start the reversal of quantitative easing at a slow pace of $ 75 billion a month, gave a respite to the markets and it reduced the anxiety of the world substantially. If FED continues its policy of gradually fading out the quantitative easing, it may not cause any kneejerk effect on the world economies and the shock will be absorbed without a major negative impact. It is a positive development for the world, which has started growing at a better rate in the recent months.

The numbers coming from the US are quite encouraging. The US economy has grown at the rate of 4.1% for the quarter ended September, 2013 and the quarter ended 31st December, 2013 looks still better. There has been an all round improvement in the US economy over the past few months and it is likely to continue. The growth is not only supported by a spike in the GDP but it is also well supported by improvement in employment in the country. The stock prices of the US companies are ruling near all time high levels and the fourth quarter results for 2013 are likely to be encouraging in most of the cases. Though quantitative easing will ease out gradually, it will hopefully not adversely impact the US economy and therefore the rest of the world. Surging US economy will help Europe to come out of its doom and green shoots have already started emerging in that economy, which faced a severe winter of economic growth over the last number of years.

Europe has started edging up its growth rate after a long time and it is expected that there is no reason for it to look back, though the recovery may not be very speedy. Germany is taking lead. Italy and France may soon follow. United Kingdom, though not in Euro zone has already started showing improvement in its economy and it is likely to grow at a decent rate after a long slumber. Improvement in Europe will positively affect the South American and North African economies, whose interest is closely connected with Europe.

Japan has started doing better and its currency has weakened substantially against the US Dollar, which is a positive news for its exports and therefore for its economy. But, for its political tension with China, the economy can do much better over the next few years on the back of increased demand from the US and Europe, provided its currency maintains its weakness.

China remains the beneficiary of the economic improvement in the developed nations as it will result in surge in demand for the Chinese products.

Its economy can improve its high growth rate but when it can hit double digit growth remains a complex question, which also has political repercussions.

The overall vision of the world for 2014 looks promising. Most of the economies have started doing better and the cumulative impact of this improvement will be visible over the next few months. Hopefully the uptrend will continue in 2014, in spite of likely gradual withdrawal of quantitative easing by the US Government and also squeezing of liquidity by many other large economies. It is expected that the world economy will grow at the rate of around 3% and that will be very good for regaining the economic tempo.

Indian economy has been struggling though it has substantial potential. The reasons are manifold which are partially created by the policies and partially by external circumstances. In the recent past, when the world was growing slowly and some of the developed economies were in recession, the Indian economy was doing reasonably well. Since last one year, the global economy has started performing better but the Indian economy is slipping on its growth rate. The probable dates of the general elections are coming nearer and uncertainty is gradually sinking in. Some populist measures are being announced and they are likely to negatively affect the effort to sustain the budgetary deficit. As the growth has slowed down, budgeted revenue is going to get affected. Disinvestment by Government is not progressing as expected and it is very likely to add to the revenue shortfall for the current fiscal. The credit side of the accounts being weak, the Government will be forced to control the debit side by reducing expenses. Reduction of expenses has its own economic implications. Reduced consumption by the Government will reduce income as well as liquidity in the economy, which in turn will reduce the consumption and so also the growth rate. Therefore, the Indian economy is in a catch 22 situation and there is not going to be an easy solution. The Governor of the Reserve Bank of India (RBI) has already warned that if a clear mandate does not emerge after the elections, then it may have serious economic repercussions. The banks in India are getting more vulnerable due to increasing credit risks and that can reduce the ability of banks to lend aggressively in the future which may affect the economic growth. The year 2014 is expected to be a difficult year for the Indian economy, though revival is likely to start in this year. If a clear electoral mandate emerges, it will result in faster decision making which can put the economy on better footing and the growth rate can reach to a higher level. As of now, the investors will have to bear with the uncertainty; though they can look at the future with cautious optimism.

The global stock markets have continued their upward movement and so also the Indian stock markets. There is a visible change in the US economy and so is the case of Europe and Japan, though their degree of improvement is not the same. The economic improvement has pushed the stock markets in those countries to higher levels and many of them are ruling near their all time high. The question with which the investors are vexed with is whether the rally has been overdone. The answer appears to be in the negative. Though the markets have acted quickly and probably in excess than expected, they are not overvalued. There is a scope for growth in the developed economies and it will provide further fuel to the rally in the stock markets of the developed countries. Indian investors can gain through investing in foreign equities either directly or through available schemes of Indian mutual funds. Year 2014 has a fair promise for the large globalised companies as well as for stock exchanges of US, Europe and Japan. The stock exchanges in other countries are also likely to reap benefits as increased global appetite will improve the corporate performance of export oriented companies and even the sentiments in their domestic stock markets will get a boost.

Stock markets in India have started improving since last few months in spite of the fact that there are a lot of concerns about the economy. A major credit for the same goes to continued FII investment, which is pouring substantial funds in the Indian stock markets, in spite of all the concerns. Further, there is a reason to believe that this flow

will continue, unless a major unfavourable event happens, affecting the developed economies. Currently, not many people fear such an occurrence and so it is expected that the uptrend will continue in the Indian stock markets for some more time. The general elections are likely to take place in the month of May and the sentiment is likely to remain positive till April, unless the budget casts uncertainties. The movement of the stock markets thereafter will depend on the political equations. If one of the political alliances gets a clear majority, the markets are likely to head northwards. However, if a hung Parliament is mandated, there can be a downturn. The stocks look like one of the preferred asset class for the Indian investors as of now. However, most of the retail investors have already shunned the investment in equity due to their unhappy past experience. They are finding solace in the investments in fixed deposits, which have yielded comparatively high returns. They have reconciled to the fact that by earning interest, though it is not easy to beat inflation, at least there are no uncertainties like stock investments. This mentality of Indian investors, especially the retail investors, will need to change or else they will miss the bus.

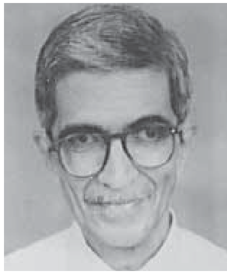
The current Government bond yield in India has crossed 9% and it can be considered high by all standards. There is no clear evidence to the effect that the trend will reverse quickly and the bond yield will go down but the opportunity cannot exist for a very long period. The high rate may prevail till the end of the financial year but thereafter, it is likely to come down unless India faces a hung Parliament after the general elections. Over the next one year, the yield should get reduced to 8% and it should result in double digit returns for the bond investors. These bonds are safer than stocks and a fair amount of allocation should be given by the investors to this asset class. It is likely to give superior returns compared to fixed deposits.

The rates of fixed deposits are ruling high and they are likely to continue for some more time. It is also possible that the RBI may increase the interest rate marginally in its next policy announcement, which can result in higher fixed deposit rates for medium and long-term deposits. The current phenomenon is very likely to continue till March and may maximum continue till the general elections but thereafter, the rates of interest need to come down. Unless they come down, the Indian economy may not get back to a growth rate of 6% and above.

The recent ready reckoner property rates in Mumbai have shown a fair amount of appreciation as compared to last year. This can make investors believe that the property prices are going up. However, deeper analysis reveals that the increase in property price is more on account of increase in taxes and duties and due to inflation. The overall registration numbers clocked during the last year reveal that the transaction counts have gone down. The property prices have definitely come down in some of the smaller towns and in many of the locations, they are holding on due to the holding power of the developers. Unless the rate of interest comes down, the demand for property may not revive. There will be more pressure on mass housing as compared to the premium properties. Some of the micro markets may show good growth but such markets will be very few. The investors are advised to exercise caution and not to get carried away by the large scale advertisements promising dreams visible in media as well as on hoardings.

The Indian currency seems to have stabilised and it is likely to remain stable for the time being. There is the possibility of its appreciation of about 35% over the next six months. After the general elections, the power equation in New Delhi will decide the further direction of the rupee.

The year 2014 has dawned with great expectations of the investors. The global micro economic environment is much better now as compared to the last year and it may improve further. There are more opportunities for the investors during the months to come and the wise investors are expected to take advantage of the same to cover up the low returns which they might have garnered over the last 5 years.



V. H. Patil, *Advocate*

YOUR QUESTIONS & OUR ANSWERS

FACTS & QUERY

Q.1 Whether the entire amount of interest on home loan and/or on borrowed capital, to purchase the house or a flat will be entitled to deduction from the rental income and/or other income, irrespective of the Quantum of Interest, under Section 24 of the Income-tax Act, 1961.

Since the limit for Claiming Deduction in respect of Loan for Home/Flat for Own Residence is limited to of ` 1,50,000.00, whether in the case of home/flat Let-Out and/or Leased-Out the interest on home loan and/or borrowed capital for purchasing of property can entirely be deducted, even if the Net Income Amounts to Loss.

Ans. The relevant provisions of the I.T. Act as are:

Income from house property

S. 22. The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

Annual value how determined

S. 23. (1) For the purposes of section 22, the annual value of any property shall be deemed to be —

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

(b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or

(c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable :

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by him) in determining the annual value of the property of that previous year in which such taxes are actually paid by him.

Explanation. — For the purposes of clause (b) or clause (c) of this sub-section, the amount of actual rent received or receivable by the owner shall not include, subject to such rules as may be made in this behalf, the amount of rent which the owner cannot realise.

(2) Where the property consists of a house or part of a house which—

(a) is in the occupation of the owner for the purposes of his own residence; or

(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 annual value of such house or part of the house shall be taken to be nil.

(3) The provisions of sub-section (2) shall not apply if —

(a) the house or part of the house is actually let during the whole or any part of the previous year; or

(b) any other benefit therefrom is derived by the owner.

(4) Where the property referred to in sub-section (2) consists of more than one house —

(a) the provisions 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 the house 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 had been let.]

Deductions from income from house property
S. 24. Income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely:—

(a) a sum equal to thirty per cent of the annual value;

(b) where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital:

Provided that in respect of property referred to in sub-section (2) of section 23, the amount of deduction shall not exceed thirty thousand rupees :

Provided further that where the property referred to in the first proviso is acquired or constructed with capital borrowed on or after the 1st day of April, 1999 and such acquisition or construction is completed [within three years from the end of the financial year in which capital was borrowed], the amount of deduction under this clause shall not exceed one lakh fifty thousand rupees.

Explanation.— Where the property has been acquired or constructed with borrowed capital, the interest, if any, payable on such capital borrowed for the period prior to the previous year in which the property has been acquired or constructed, as reduced by any part thereof allowed as deduction under any other provision of this Act, shall be deducted under this clause in equal instalments for the said previous year and for each of the four immediately succeeding previous years:]

[**Provided** also that no deduction shall be made under the second proviso unless the assessee furnishes a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

Explanation.—For the purposes of this proviso, the expression "new loan" means the whole or any part of a loan taken by the assessee subsequent to the capital borrowed, for the purpose of repayment of such capital.]

Now the issue is clear that only in respect of house property for the purpose of self residence, is subject to limit of loan, is applicable. If the

house property is not used for one's own residence but which is let out to another or in respect of property used for commercial purpose, or let out for commercial purpose like shop, then also the said limit is not applicable. The reasons for this different treatment is any property used for one's own residence is exempt from being taxed under income from house property under S. 22 of the Act. Any house property not used for one's own residential purposes is not exempt from such taxation.

As such in case of such property the entire interest is allowable which is paid on house loan will be allowable by way of deduction against the house property income. As income includes loss on such deduction it may be a loss.

Q.2 *Can a house situated out of India be claimed as exempt u/s. 5(vi) of Wealth Tax?*

Ans. Now if one has a house property it is exempt from liability for Wealth Tax. The fact that the House Property is situated outside India is not material, provided the conditions under S. 5(vi) are fulfillled, one can claim exemption in respect of House Property situated outside India.

Q.3 *In case of e-filing of return of deceased assessee by legal heir requires the legal heir to obtain a legal heir certificate. Such a condition is not required in case of manual filing of returns. Is this condition valid?*

Ans. Such condition imposed may be very unfair but it is not invalid.

What the querist should do is to make a representation to the Govt. for delition of said condition on the ground that, it does not serve any purpose. If the Govt. does not oblige, then querist may challenginge it in a court, by a writ petition.

Q.4 *The AO has made a high-pitched assessment assessing the income at 11 times the returned income only because the creditors of the company did not confirm the purchases made by the assessee company in time of 15 days, though the same were submitted to the AO during the course of assessment. Assessee preferred an appeal and simultaneously a stay application to the AO and CIT(A). Without disposing off the stay application the AO initiated recovery proceedings against the assessee by attaching the bank accounts of the assessee. When the fact that the stay application was not yet disposed of was brought to the notice of the AO he released the bank accounts. The AO has not yet granted stay.*

a. What should be the future course of action of the assessee till the appeal is disposed of?

Ans. If the A.O. continues to recover by attaching your bank accounts you should ask for a stay by CIT(A) before whom your appeal is pending for a stay of recovery proceedings, during the pendency of the appeal proceedings. If he refuses to stay you can go in appeal to I.T.A.T.

Q.5 *A, B, C, D and E are five friends who purchased various pieces of land of different size on different dates in their individual names on different dates. All the plots of land are adjoining to each other. Now they have started construction of building on those plots. No agreement has been entered into between them. They have opened on bank account in which sale/booking amount is credited and after meeting expenses, balance amount is divided amongst these five persons. Buildings are still under construction and conveyance of land shall be made in favour of co-op society to be formed after completion of the project. The queries are*

b. What is the status – Whether partnership, AOP or individual?

c. At what point of time capital gain on land will arise?

d. At what point of time income from business will be taxed i.e. after the project is completed or every year on the basis of percentage of completion of the project or on the basis of sales?

Ans. Now in the case of the querist two issues arise, one of the Capital Gain in respect of lands of the owners which they converted them into

stock-in-trade and brought the same in the Joint Venture Agreement and two in respect of business income in respect of work done as building construction.

As regards issue No. one –

Under General Law, a transfer is complete only when an unconditional possession of the property, the subject-matter of transfer is handed over to the transferee by the transferor or when a conveyance relating to that property is executed and the document of conveyance is duly registered. Till then the transfer is not complete under the provisions of Transfer of Property Act. and also under I.T. Act, 1961.

Applying these provisions of taxation of profits in case of building contract, relating to construction of a building for a co-operative society, the transfer of property is completed, only when an unconditional possession of the property under development of the premises constructed on the said land, is given to the Developers, or when on unconditional possession is given to the purchaser of the flats constructed or when final conveyance deed is executed between the owner of the property and the co-operative society formed and duly registered and such society on proper application from concerned persons, accepts such purchaser as a member of the co-operative society so formed. Till then the transfer is not complete in case of the original owner and the developer and flat purchasers, etc., and there arises no liability to taxation.

As regards issue No. two:

The clear position in law is a building contractor can adopt either project completion basis as his method of accounting or the basis of valuation of stock-in-trade of the project, offer some part of valuation of the closing stock for every year and offer it for taxation and in the year of completion of the project after ascertaining the total income and tax payable on it deducting from the tax liability so computed on that income, after deducting taxes already paid in the earlier years, pay the remaining tax in the year of completion of the project.

In case of project completion basis of the method of accounting, the profits of the project of construction are offered for taxation only after the completion of the project. Till then the work-in-progress is carried forward every year and in the year of completion of the project, the total profits are offered for taxation.

However it must be noted that whichever method of accounting is followed, only the real profits will have to be taxed.

As such in the case of the querist, neither capital gain or business income has arisen as on today in the case of capital gain as the final conversion has not been executed between the owners of the lands and the co-operative society to be formed, nor an unconditional possession is given to the purchasers of the flats. As far as the business income, if the querist follows the project completion basis then the liability will arise only on the completion of the building project.

"Just because you're not sick doesn't mean you're healthy"

— *Author Unknown*

"Those who think they have no time for exercise will sooner or later have to find time for illness."

—*Edward Stanley*

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Hitesh R. Shah & Hinesh R. Doshi, *Hon. Jt. Secretaries*

THE CHAMBER NEWS

Important events and happenings that took place between 8th December, 2013 to 8th January, 2014 are being reported as under.

I. Admission of New Members

1) The following are the new members, who were admitted in the Managing Council Meeting held on 18th December, 2013.

Life Membership

1	Mr. Boob Satish Bhikulal	ITP	Nashik

Ordinary Membership

1	Mrs. Chandak Dipika Giriraj	CA	Mumbai
2	Mr. Malpathak Rajiv Jagadish	CA	Nashik
3	Mr. Modak Milind Chandrashekhar	CA	Nashik
4	Mr. Mehta Bhavesh Mulraj	CA	Mumbai
5	Mr. Vakharia Kantilal Bhagwanji	CA	Mumbai
6	Mr. Agrawal Mahesh Ranchhodas	Advocate	Indore
7	Mr. Enukondla Phalguna Kumar	CA	Tirupati
8	Mr. Kothawaoe Anil Shankar October 2013 to March 2014)	CA	Nashik

Student Membership

1	Mr. Satam Tanmay Jaising	Final CA
2	Mr. Shah Aman Rakesh	Final CA

II. Past Programmes

Details of programmes conducted by the Chamber are given below:

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
1	**Direct Taxes Committee**		
A)	*6th Intensive Study Group (Direct Tax) Meeting* at CTC Office	**23rd December, 2013** Recent Important Decisions under Direct Taxes	CA Natwar Thakrar
2	**Indirect Taxes Committee**		
A)	2nd Residential Refresher Course on Service Tax at The Lagoona Resort, Lonawala – 410 403.	**3rd January, 2014 to 5th January, 2014**	
		Paper – I : Service Tax & VAT on Composite Transactions	Mr. P. K. Sahu, Advocate, Delhi
		Paper – II : CENVAT Credit Mechanism for Service Providers	Mr. V. Raghuraman, Advocate, Bengaluru
		Paper – III : Case Studies under Service Tax	CA Parind A. Mehta
		Presentation : Prosecution, Arrest and Recovery provisions under Service Tax Legislations	Mr. V. Sridharan,. Advocate
3	**International Taxation Committee**		
A)	*Intensive Study Group on Int. Taxation Meeting* at CTC Office	**10th December, 2013** Recent OCED Actions on Base Erosion and Profit Shifting	CA Nilesh Kapadia
B)	*Workshop on Taxation of Foreign Remittances* At M. C. Ghia Hall.	**13th, 14th, 20th & 21st December, 2013**	Faculties: S/Shri Vispi T. Patel, Sushil Lakhani, Rashmin Sanghvi, Milind Kothari, Nilesh Kapadia, Naresh Ajwani, Radhakishan Rawal, Sudhir Nayak, N. C. Hegde, Chandrahas Gupta, Sanjay Sanghvi, Sanjeev Sharma Brain Trustees: S/Shri Sunil D. Shah, and M. P. Lohia.

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
4	**Membership & EOP Committee**		
	Self Awareness Series at CTC Office	**8th January, 2014** Universality of Indian Culture	CA Jawahar Baxi
5	**Study Circle & Study Group**		
A)	*Study Circle on International Taxation Meeting* at CTC Conference Room	**17th December, 2013** Service PE – Basic Concepts and Related Issues	CA Kartik Badiani
III.	**FUTURE PROGRAMMES**		

Future programmes of the Chamber's are as follows:

Sr. No.	Programme Name / Committee / Venue	Day / Subjects	Speakers / Chairman
1.	**Allied Laws Committee**		
A)	Full Day Seminar on Charitable Trusts (Jointly with BCAS) at M. C. Ghia Hall	**22nd March, 2014** Charitable Trusts	CA Arvind Dalal CA Gautam Nayak CA Vipin Batavia CA Anil Sathe CA Paras Savla
2.	**Corporate Members Committee**		
A)	**Workshop on Companies Act, 2013** at Babubhai Chinai Hall, IMC	**14th, 15th, 25th & 29th March, 2014** 1. Keynote Address 2. Amendments pertaining to Accounts and Audit 3. Company formation & Management & New Concepts like OPC, Small Company 4. Important Amendments affecting Private Companies & unlisted Public Companies 5. Provisions relating to BoD, Independent Directors, Audit Committee, N & R Committee & other mandatory Committees 6. Merger & Acquisition 7. CSR 8. Company Law, 2013 vis-à-vis IFRS	*CA P. N. Shah, Past President, ICAI CA N. P. Sarda, Past President, ICAI Eminent Faculty CA Nilesh Vikamsey *Dr. V. R. Narasimhan, Chief-Regulation National Stock Exchange of India Ltd. Shri Nitin Potdar, Solicitor Eminent Faculty *CA Jayesh Gandhi *(* - Subject to confirmation)*

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
3.	**Direct Taxes Committee**		
A)	*The Dastur Essay Competition* (For Students of Law & Accountancy)	The Topics for Essay Competition (a) Ideal Education ….. What is required to be done? (b) Is Sports becoming Business and Business less Sporty? (c) Is Democratic Form of Government Best for India?	The Members are requested to encourage their Article Trainees and Law Students to participate in this competition. *For more details and the Rules, please visit on our website www.ctconline.org*
B)	*7th Intensive Study Group (Direct Tax) Meeting* at CTC Office	**21st January, 2014** Recent Important Decisions under Direct Taxes	Shri Vinod Kumar Jain, Advocate
C)	*8th Intensive Study Group (Direct Tax) Meeting* at CTC Office	**20th February, 2014** Recent Important Decisions under Direct Taxes	Shri R. K. Sinha, Retd. IRS Officer
4.	**Information Technology Committee**		
A)	*Info Tech Update Series Workshop* at Kilachand Hall, IMC.	**23rd January, 2014** Smart apps for Tax Professionals (How to get the most out of your smart phone)	CA Sanjay Chheda CA Samir Kapadia
5.	**Indirect Taxes Committee**		
A)	*Workshop on MVAT Act & Allied Laws* (Jointly with STPAM, BCAS, AIFTP & WIRC of ICAI) at Mazgaon Library, Vikrikar Bhavan, Mumbai	**18th January, 2014 to 3rd May, 2014** The topics selected for workshop are issues based and will cover MVAT Act, 2002, CST Act, 1956, Service Tax provisions and newly introduced provisions of LBT Act. These topics are of immense importance and will be of enormous held and use to professionals practicing in Indirect Taxes (Two Jugal-bandi Lectures have been arranged in the month of February, 2014)	CA Rajat Talati CA Janak Vaghani Shri Ratan Samal, Advocate Shri C. B. Thakar, Advocate CA Vikram Mehta CA Ashit Shah Shri Vinayak Patkar, Advocate Ms. Nikita Badheka, Advocate CA Rajiv Luthia Shri Vidyadhar Apte, Advocate CA Jayesh Gogri CA Naresh Sheth Shri Deepak Bapat, Advocate Shri Kishor Lulla, Advocate

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
6.	**International Taxation Committee**		
A)	*5th International Tax Conference* at Hotel Sahara Star, Vile Parle	**28th February & 1st March, 2014** **1.** Keynote Address	Senior official from CBDT
		2. Permanent Establishment - Emerging Issues including issues and Challenges in Digital Economy	CA Geeta Jani
		3. GAAR – Issues and Challenges in Implementation (with Case studies impacting Inbound and Outbound Investments) and global developments concerning GAAR	Shri Kuntal Sen, IRS
		4. Transfer Pricing : Emerging Controversies and Challenges – Way Forward	CA Vispi Patel
		5. Transfer Pricing structuring of Business Re-organisation and Issues	CA Sanjay Tolia
		6. Case Studies on Service Tax on Cross border Transactions	Eminent Faculty
		7. Emerging International Tax Trends and India's Tax Treaty Policy	Senior Official from CBDT
		8. Case studies on International Taxation and Transfer Pricing – Panel Discussion	Panellist : Shri Sunil Lala, Advocate, *Shri Kanchun Kaushal, Advocate and CA Pinakin Desai (Chairman) *(* Subject to Confirmation)*

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
B)	*Transfer Pricing Study Circle* at CTC office	**January 2014 to December 2014** The Study Circle is aimed at in-depth analysis of Law, Procedure and Jurisprudence with case studies	**Mentors:** Shri Samir Gandhi Shri Sanjay Tolia Ms. Karishma Phaterphekar
C)	*Intensive Study Course on FEMA* At West End Hotel	**18th, 19th, 25th & 26th April, 2014** **1.** Introduction and Overview of FEMA 2. Entry strategy, Establishment of branch / project office by Non-residents in India 3. Import and Export of Goods and Services 4. Bank Accounts and Deposit Regulations 5. Borrowings and Lending in Rupees and Foreign Currency 6. Investment in Immovable Property in India and outside India 7. Inbound Investment – Foreign Direct Investment, portfolio and other avenues of Investment 8. Inbound Investment – other than FDI 9. Outbound Investment 10. Miscellaneous Remittances, Import, Exports and retention of currencies, Repatriation of Foreign Exchange 11. Adjudication and Compounding of Contraventions 12. Brain Trust, FAQs, Practical Case Studies	Eminent Faculties (Kindly block your dates and please await for detailed Announcement in few days)

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
D)	*4th Intensive Study Course on Transfer Pricing* (Including Domestic Transfer Pricing) **24 Sessions – 6 Days** at West End Hotel	**8th & 22nd March, 2014** **4th & 5th April, 2014** **11th & 12th April, 2014** a) Basics of Transfer Pricing b) Benchmarking c) Industry Specific Sessions d) Key Controversy Areas – Recent TP Audit experience e) Practice Areas f) Other areas having TP implications g) Domestic Transfer Pricing h) The Road Ahead i) Attribution issues, experiences, recent rulings and Revenue's perspective	Eminent speakers from the profession and revenue department
7.	**Residential Refresher Course & Public Relations Committee**		
A)	*37th Residential Refresher Course* at Anandha Inn Convention Centre & Suites, Pondicherry	**13th February, 2014 to 16th February, 2014** • Reassessments / Revision / Rectification • Case Study under Direct Taxes Case Study under Direct Taxes • Case Study in Taxation of Real Estate Transactions [Secs. 2(1A), 2(14), 43CA, 50C, 50D, 56(2)(vii)(b), 145 & TAS and 194-IA) • Brains' Trust : Direct Tax	Paper Writer : CA Mahendra Sanghvi Chairman : Shri Keshav Bhujle, Advocate Paper Writer : Dr. Anita Sumanth, Advocate (Chennai) Chairman: Shri S. N. Inamdar, Sr. Advocate Paper Writer : CA Pradip Kapasi Brains' Trustee : Shri Arvind Datar, Sr. Advocate (Chennai)

Sr. No.	Programme Name / Committee/Venue	Date / Subjects	Chairman / Speakers
B)	2nd Chamber Premier League, 2014 (CPL) RRC & PR Committee jointly with Membership & EOP Committee	**18th January, 2014** (Interested members may send their enrolment along with Player's Participation Fee to the Chamber's office on or before **15th January, 2014)**	The enrolment is restricted to 60 on first cum first served basis.
8.	**Study Circle & Study Group Committee:**		
A) i	*Study Group Meetings* at Babubhai Chinai Committee Room, IMC	**30th January, 2014** Recent Judgments under Direct Taxes	Shri Vipul Joshi, Advocate
ii		21st February, 2014 Recent Judgments under Direct Taxes	CA Yogesh Thar
B)	*Study Circle on International Taxation Meeting* (Jointly with Intensive Study Group on International Taxation) at Kilachand Hall, IMC	**16th January, 2014** Discussion of brief report on the UN Meeting of Committee of Experts on International Co-operation in Tax Matters (October, 2013) & Taxation of E-Commerce – Issues & Views	CA Nilesh Kapadia

IV. Forthcoming Journal by Journal Committee

The Chamber's Journal for the month of February, 2014 will cover topic on "International Taxation".

V. Publications for Sale

A) International Taxation – A Compendium

Four hardbound volumes set containing approx. 4,000 pages.

(For Enrollment and further details of all the Future Events, please refer to the January, 2014 Issue of CITC News or visit the website www.ctconline.org)

"When health is absent, wisdom cannot reveal itself, art cannot manifest, strength cannot fight, wealth becomes useless, and intelligence cannot be applied."

— *Herophilus*

DIRECT TAXES COMMITTEE

Full Day Seminar on Search & Seizure and Survey held on 7th December, 2013 at West End Hotel.

CA Yatin Desai, President welcoming the Guests & participants. Seen from L to R : S/Shri CA Ketan Vajani, Vice Chairman, Dr. K. Shivaram, Advocate, Faculty, Ajay Singh, Advocate, Chairman, and Bhavik Shah, Convenor.

Shri Ajay Singh, Chairman addressing the participants. Seen from L to R: S/Shri CA Ketan Vajani, Vice Chairman, CA Yatin Desai, President, Dr. K. Shivaram, Advocate and Bhavik Shah, Convenor.

Dr. K. Shivaram, Advocate addressing the delegates. Seen from L to R: S/Shri CA Yatin Desai, President, Ajay Singh, Advocate, Chairman and CA Bhavik Shah, Convenor.

CA Sunil Talati addressing the delegates. Seen from L to R : CA Ketan Vajani, Vice Chairman, CA Hitesh Shah, Hon. Jt. Secretary and CA Rahul Sarda.

DIRECT TAXES COMMITTEE

Full Day Seminar on Search & Seizure and Survey held on 7th December, 2013 at West End Hotel.

CA Reepal Tralshawala addressing the delegates. Seen from L to R: S/Shri Ajay Singh, Advocate, Chairman, CA Avinash Lalwani, Hon. Treasurer and CA Dinesh Poddar, Convenor.

CA Vipul Joshi, Advocate addressing the delegates. Seen from L to R : S/Shri Ajay Singh, Advocate, Chairman, CA Yatin Desai, President and CA Dinesh Poddar, Convenor.

Section of delegates

6th Intensive Study Group (Direct Tax) Meeting held on 23rd December, 2013 on the subject "Recent Important Decisions under Direct Taxes".

CA Natwar Thakrar addressing the members.

INTERNATIONAL TAXATION COMMITTEE

Intensive Study Group on International Taxation Meeting held on 10th December, 2013 on the subject "Recent OCED Actions on Base Erosion and Profit Shifting".

CA Nilesh Kapadia addressing the members.

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Circle on International Taxation Meeting held on 17th December, 2013 on the subject "Service PE – Basic Concepts and Related Issues".

CA Kartik Badiani addressing the members.

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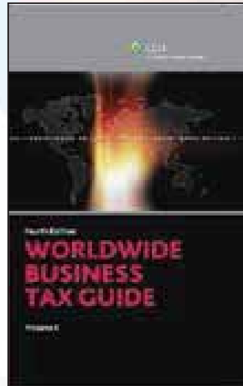
New Releases



Worldwide Business Tax Guide (3 Volumes), 4/e

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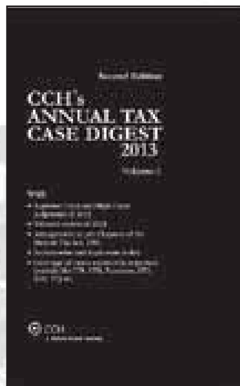

CCH's Annual Tax Case Digest 2013 (2 Volumes), 2/e

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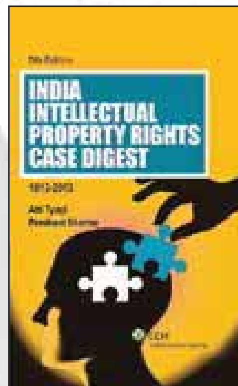

India Intellectual Property Rights Case Digest, 5/e

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Due Diligence under Foreign Exchange Management Act, 1999

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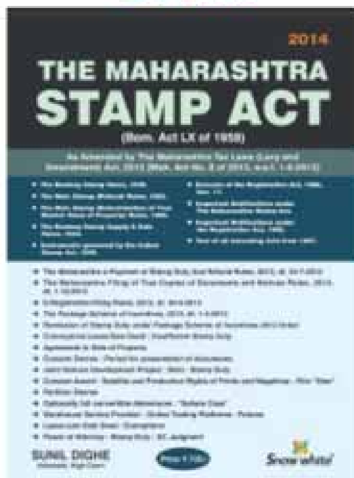

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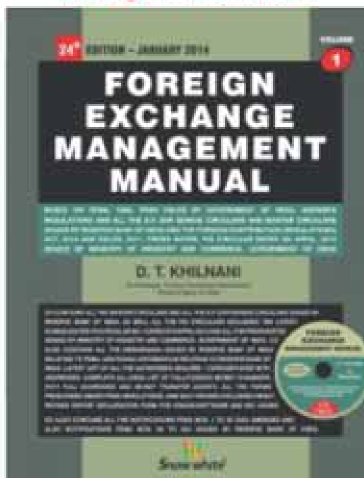

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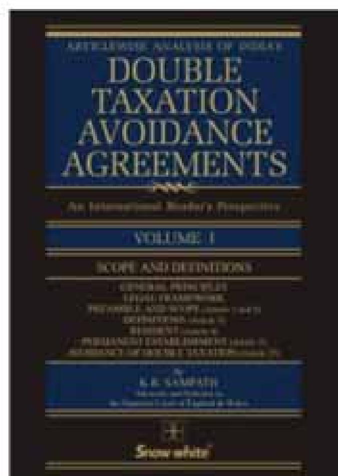

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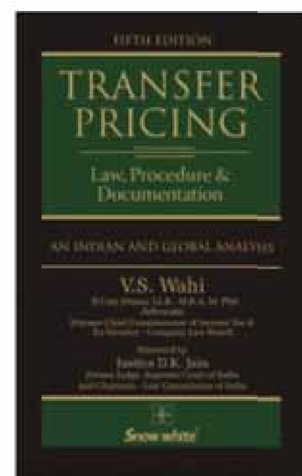

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