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Tax Audit and MAT – Recent Developments

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THE CHAMBER OF TAX CONSULTANTS
3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 / 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

The Chamber's Journal

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Editorial

On 9th August, 1942, 75 years back, from our own city of Mumbai, Mahatma Gandhi gave the final call to British to "Quit India" and to the citizens of India "Do or Die". The following five years were very crucial in the history of our freedom struggle. Mahatma Gandhi ensured participation of all sections of the society in the freedom struggle through his novel methods. The main leaders of the freedom struggle were professionals. These professionals played an important role in post-independence era when our country was putting together a constitution which will weave the nation out of diverse cultures, communities, languages, religion, etc. The main weapon of his soldiers was their willpower. The struggle bore its fruit. The British exited this nation in a hurry but not without harming the subcontinent by creating political entities on religious lines. The divide created in this region and the seeds of corruption sown by them are harming the interests of people living in this subcontinent even now. Even after 70 years of Independence, we are suffering the legacy left behind by the British. But, with the recent developments, I am optimistic that the future generations will take the right steps to undo the wrongs committed by them.

The Special Story of the present issue of the Chamber's Journal is on Tax Audit and MAT – Recent Developments. The Journal Committee has chosen this topic for the month of August as the Chartered Accountants are getting ready for the audit season. My friend Mr. Anil Sathe, in his article, has briefly referred to the history of section 44AB. Other authors have dealt upon the subject in a very careful and detailed manner. So I will avoid duplication. Here, it may not be out of place to mention that the initial intention of introduction of 44AB was to provide assistance to the department in framing the assessment orders. To what extent this object is achieved is a matter of debate. The introduction of tax audit has benefited both the assessees as well as the Department. However, there are certain issues which we professionals find difficult to accept. When there is an independent body to prescribe the Accounting Standards, why each and every statute should separately come up with their own set of accounting standards. I am referring to ICDS. I am of the view that the CBDT should not have come up with ICDS. It is an interested party in collecting revenue. The Accounting Standards have a much larger role to play than facilitate collection of revenue.

There is a lot which can be said and debated upon but the bottom line is, due to increased cost of compliance, a professional is considered by the assessee as an unnecessary burden and the tax authorities consider them as hindrance. This is not an ideal situation. It has to be altered to make the tax administration in our country seamless.

I thank all the contributors to this issue of Chamber's Journal for taking out time for the Journal.

K. GOPAL
Editor

From the President

Dear Members,

Namaste

Salute to the ones who have kept us safe and whose sacrifices keep us free, to live the lives we want to.

Wishing you all a very Happy Independence Day.

This month marks the beginning of festive season. These are the occasions when we meet our families and friends. The time spent with our family and friends is the best moments of our life which we always cherish. Along with this festive season, we, the professionals also have to adhere to our professional commitments and it is the proper time management that helps us to maintain the balance between work, family and friends.

Government's path-breaking initiative of implementation of GST has opened up a new era in Tax structure. One Nation – One Tax is an ideal situation which has been welcomed with open arms. However Government should ensure the necessary infrastructure for filing and uploading the returns should be made available. We all have faced the plight of the Income tax site during last month. Where there is a legal duty cast on the citizens to file their returns on time, there is also a legal right to demand adequate and necessary infrastructure.

It is good news that Government has considered to reduce rates of GST on some essential items. However, there are still many essential items which requires reconsideration.

As per the Finance Ministry, 12.6 million new taxpayers were added last financial year to the tax base. It is indeed a very impressive 27% growth in taxpayers, but now the next step should be to increase the level of sophistication with which information technology tools are used. With the increase in electronic transaction, Government needs to upgrade tax department technology which will enable better compliance, curb tax evasion by mining the data thrown up in electronic transaction and thereby avoid corruption at various levels. It will also help in better co-ordination by transfer of information between different Government agencies.

Though with a major leap in the tax structure, the Government has yet to make such pioneering initiation in other sphere too, one of them being the Indian Education System. The recent controversy about the declaration of various results by Mumbai University which are still pending shows the poor state of affairs. As per the statistics available in media, about 55% of the results are yet to be declared. Out of 477 exams which the Mumbai University held this summer, results of only 268 exams were released till 5th August, 2017. India is a proud nation with a very high number of youth generations, but mess like this threatens to leave a big question mark over the future of these students. Person in charge of affairs be held accountable and liable for the mess. Government needs to look into the matter on priority basis as futures of the students are at stake who are the future pioneers of our country.

The recent allegation surfaced in media of "horse trading" in the election process leaves a question mark on the integrity and credibility of political parties. Professionals can play greater role in politics. Perception that politics is dirty and corrupt is merely an excuse to rescue ourselves from the duty to lead. Professional contributions towards nation building cannot be undermined. In recent years the decentralisation of fiscal power to cities has galvanised a new wave of civic activism through welfare association and citizen groups. So it does make sense for a professional to provide its expertise to such group.

Recent income tax raid on Energy Minister of Karnataka State and his associates ended with a seizure worth ₹ 300 crores. Also, the recent enquiry on Bihar Ministers for benami property is under investigation by Enforcement Directorate involving more than hundred crores of benami property. Considering these seizures and investigation it requires that norms should be set for compulsory scrutiny of Income tax return filed by all Union and State Ministers. This will be a small beginning in cleaning the whole system.

It will be wonderful if our politicians and bureaucrats start addressing more germane issues and devoting energies and Government machinery to good governance rather raising trivial issues and matters.

I am at pains to read the recent news of suicides by youths. It requires us to revisit our roots and regain the confidence in our youth to stand-up to failures and handle the stress at their level. They should be taught that one shouldn't be afraid to fail. Learning from failure lead to success. If you haven't failed, you don't know how success feels like. The need to include spirituality in education is the need of an hour. One should appreciate and accept that everything in life happens for a reason.

The Constitution Bench of Supreme Court is presently hearing arguments on whether Indians have right to privacy and whether Aadhaar violates that right. The main contention is that Aadhaar violates our right to privacy and takes our personal information for various purposes. It will be interesting to know the path breaking judgment. The way things are going, I wouldn't be surprised if Aadhaar becomes mandatory for practically everything between birth and death.

The search for human freedom can never be complete without freedom for women. Chandigarh Stalking case highlights twin evils of VIP culture and lack of women's safety. The brave girl Varnika Kundu, is among those rare women who actually spoke out about their ordeal. She has vowed to pursue justice and set an example for all.

Chamber had taken swift action is raising concern of taxpayers as well as professional in regards to Income tax return filing, which has brought fruitful result. I congratulate the L & R Committee Chairman and his team for the efforts put in at such a short notice. I believe Government is open to hear our grievances; we need to be proactive in pointing out the concerns of citizens and professionals to get it corrected.

The IT Connect Committee had organised a wonderful mega programme on GST Return filing and software, which is the need of the hour. A very successful programme and well attended by participants. I congratulate the Chairman and his team for the success.

Team Chamber is in grief on demise of our Core Group Member Mr. Bharat M. Shemlani. The Team Chamber shares the grief of his family members and we pray that the departed soul may rest in eternal peace.

Research shows that one is at greater risk of heart disease without a strong network of friends and family. Social engagement is associated with a stronger immune system especially for the urban professionals. Spend quality time with family and friends during this festive season.

We are getting better in the way we execute our events and deliver values to all of you. We welcome your feedback and suggestions.

The Special Story for this month is on "Tax Audit & MAT – Recent Developments". I thank all the authors for sparing valuable time and for their contribution to the Chamber's Journal for this month.

At the end, I conclude with:

"Thousands of candles can be lighted from a single candle, and the life of the candle will not be shortened. Happiness never decreases by being shared"

Jai Hind.

AJAY R. SINGH
President

Chairman's Communication

Dear Readers,

Over the past more than a month there have been lot of developments politically and in the economy. Mr. Ram Nath Kovind was elected as the 14th President of the country on 25th July, 2017. Mr. Venakiya Naidu was elected as the Vice-President of the country on 5th August, 2017. There has been change of political equations in Bihar too! In the recent monetary policy of RBI , there is an interest cut by 25 basis points. This the first cut by the Reserve Bank of India after October 2016. In the last four consecutive meetings, the RBI has left the repo rate unchanged. Also, now the repo rate, at 6 per cent, is at over six-and-half years' low. Despite the clear pressure on the banks' net interest margins (NIM), the RBI still thinks there is scope for further reduction in the lending rates. According to the Governor Urjit Patel, the transmission of the rate cuts has been much stronger in segments where the competition is fierce, such as home loans, personal loans, etc. According to him, given the liquidity situation prevailing in the market, there is scope for banks to cut their lending rate further.

The Government added 9.1 million new taxpayers in 2016-17, an 80% increase over the typical yearly rise, highlighting the impact of India's November demonetisation of high-value currencies. This is expected to significantly boost the Government's tax revenue. India had only 55.9 million individual taxpayers at the end of 2015-16. All these developments seem to have been taken positively by investors globally and Nifty made history by crossing 10,000 mark first time ever. The Stock Market, the economy's barometer continues to buoy!

It is always the endeavour of the Journal Committee to bring out the issues which are relevant and useful at the right time. Busy season of Tax Audit has now started and therefore this issue of the Journal is devoted to Tax Audit and MAT. Tax Audit is now applicable for more than three decades and therefore lot of material including Guidance Note from the ICAI on the subject is available. However, there continues to be some developments in terms of change in reporting requirement etc. which needs deliberations and guidance from experts. For A.Y.2017-18, Income Computation and Disclosure Standards are mandatory and there are reporting requirement in respect thereof incorporated in Form 3CD There are also amendments in MAT provisions in respect of companies to which Ind AS applicable. Tax audit cast a huge professional responsibility on auditors and therefore we have covered topic of applicable Accounting Standards and Standards on Auditing. We have invited eminent professionals who are expert in the subject to write articles. I am sure the readers would be benefited by their expert knowledge.

New columns

There have been lot of developments in Accounting and Auditing field during the past few years as also in corporate laws. GST of course is an evolving law. Considering this, the Journal Committee has introduced three new regular columns for the benefit of members from this issue :

1. **GST Gyan:** Important topics in GST shall be covered in this column.

2. **Corporate Law – Recent Developments :** Topics relevant for members will be covered in this column. This issue covers Companies (Amendment) Act, 2017.

3. **In Focus – Accounting and Auditing :** Important developments in the area of accounting (including Ind AS) and auditing will be discussed in this issue. This column is being introduced with the support of Accounting and Auditing Committee of the Chamber.

I wish to put on record my sincere appreciation for Vice-Chairman Bhadresh Doshi and Convenor Toral Shah for designing this issue and also for overall co-ordination. My gratitude to all the learned authors for sparing their valuable time and sharing their knowledge

VIPUL K. CHOKSI
Chairman – Journal Committee

OBITUARY

CA Bharat Shemlani passed away on 5th August, 2017 at the young age of 49 years.

Bharat as everyone is aware had carved out a niche for himself in the area of Indirect Taxes and was one of the regular contributors, as speaker or as author for various professional organisations including Chamber for the past several years. He was the author for the regular column 'Service Tax – Case Law Update' in Chamber's Journal for ast more than 12 years.

Besides being a brilliant professional, Bharat was extremely humble, down to earth and a simple human being. The following instance explains how sincere and dedicated a professional Bharat was.

Bharat had a personal tragedy about three years back when he lost his dear wife. Two days after her sad demise, Bharat was supposed to give his write up for the regular column in Chamber's Journal. He gave the write up on scheduled date without any reminder from Chamber's office !

With the untimely death of Bharat, the profession and Chamber has lost an outstanding professional and a very good human being. We pray to the almighty for eternal peace to the departed soul.

CA C. N. Vaze

Tax Audit and MAT – Recent Developments – An Overview

Introduction

Tax Audit has stayed with us over three decades. Its introduction for the first time in assessment year 1984-85 aroused a huge hue-and-cry in the tax-paying community and resistance from the tax-professionals. There was panic. Now, we have become used to it. Since the tax-audits are required to be completed on or before 30th of September, this is the opportune time to refresh our knowledge, revisit the controversies and gear ourselves up to meet the deadline.

The title of the topic is rather intriguing. It states 'Recent Controversies'. One wonders what can be considered as 'recent'. Unfortunately in our present system, 30 years is perhaps too short a period for a controversy to be resolved! Even the basic things like what is business and what is profession; what is turnover are not free from debate.

The predicament of accountancy profession is most unenviable. On one hand, tax-audit is a professional opportunity and on the other hand it is a big challenge to strike a balance between conflicting forces.

A chaotic situation is created due to the tug of war among expectations of the tax-payers, directions of the regulatory body viz., Institute of Chartered Accountants of India (ICAI), attitude of the revenue authorities and functioning of the judicial system.

Points that appear to be settled get suddenly unsettled. Innumerable intellectual mandays and resources are lost in this process.

Controversies – Inherent and inevitable

Law is a refined common sense. It is 'common sense' written in refined language. However, the human tendency is that when there are vested interests, all the other considerations are alien! The substance, object and spirit of law are given a go-bye. The adjudicating authorities scrupulously avoid to apply the 'first principle' and often add to the confusion and controversies.

The observations of an eminent jurist Mr. Fali Nariman are very speaking. He says -

"There are just too many judgments reported which have to be cited, which have to be looked into, followed or distinguished, all of which take a vast amount of judicial time". The blame for this lies partially on "overweening judicial vanity", partially on the lawyers who perceive that "everything that is said in each and every

judgment or order of the highest court in any particular case has to be presented as binding law" and partially on competing law reporting agencies "who want their law reports to sell as widely as possible". One of his conclusions is that the "Laws proverbial delays are not because there are too many laws but because there are just too many judgments and orders concerning them".

Therefore, unless all the concerned parties resolve to adopt a sensible and problem-solving approach, things will not improve. But this is a dream situation. Till then, such 'issues' of CTC will continue to be released.

Simplification: An illusive concept

Another menace is the Government's perception about 'simplification'. They resort to such an oversimplification that it becomes dreadful. Classic example is the presumptive taxation u/s. 44AD and 44ADA. The harsh part is that no remuneration to partners is allowed as a separate deduction, unlike in the past. There was absolutely no need to withdraw this provision. It is also very burdensome for small professionals.

Further, the non-allowability of remuneration may deprive the partners of legitimate deductions u/s. 80C, 80D, 80G etc.

Auditor's predicament

Auditor's independence was always a myth. Introduction of Income Computation and Disclosure Standards ('ICDS') has made the situation further embarrassing for him.

All these years, the auditor's job was only up to the issuance of tax-audit report. Actual computation of income was the responsibility of the assessee. Henceforth, due to ICDS, an auditor is virtually expected to certify the computation of income. Now, in Form 3CD, there is a specific reporting requirement on ICDS.

Whether tax audit is for preparation of Form 3CD or is it a verification of Form 3CD – is one more question to be answered. Fortunately, ICAI Guidance Note on tax-audit makes it clear that it is the responsibility of the assessee to prepare Form 3CD and the auditor is required to verify its correctness and report on the same. The Guidance Note also states that the contents of Form 3CD are to be authenticated by the assessee. Therefore, it is advisable for the auditor to obtain signature of the assessee on Form 3CD as well (refer para 16 of the Guidance Note 2014 edition).

It is a common situation especially in a proprietary concern that the proprietor's personal transactions are mixed up with business transactions and form part of the books of account. E.g. proprietor's residential house, financial investments etc. are routed through the bank accounts of the business. It is desirable ideally to avoid such things by advising the assessee to route such transactions through a separate bank account; or through his capital account. This will ensure that the auditor is certifying only the accounts of the business / profession.

Change in Form 3CA / 3 CB

These formats have been prescribed in the Income Tax Rules, 1962. Strictly speaking, one is not permitted to deviate from the same. One cannot make alterations in the Form as such.

However, the tax auditor is free to make any observations / comments in the space provided in the forms. Any adverse opinion or disclaimer of opinion can also be given in the said space.

Revision of Form 3CD

The Guidance Note on tax-audit issued by ICAI – para 13.11, drawing attention to SA 560, has given certain guidelines on revision of Form 3CD. It reads as follows:

"13.11 In certain cases, members are called upon to report on the accounts reopened and revised by the board of directors. The accounts of a company once adopted at its annual general meeting should not normally be reopened and revised. The Institute and the Ministry of Corporate Affairs have affirmed this position. In case of revision, the audit report should be given in the manner as required by the Institute in SA-560 (Revised), Subsequent Events. The Ministry of Corporate Affairs had also clarified that accounts can be revised to comply with technical requirements. It may be pointed out that report under section 44AB should not normally be revised. However, sometimes a member may be required to revise his tax audit report on grounds such as:

(i) Revision of accounts of a company after its adoption in annual general meeting.

(ii) Change of law e.g., retrospective amendment.

(iii) Change in interpretation, e.g. CBDT Circular, judgments, etc.

13.12 In case where a member is called upon to report on the revised accounts, then he must mention in the revised report that the said report is a revised report and a reference should be made to the earlier report also. In the revised report, reasons for revising the report should also be mentioned".

Multiple auditors for branches / businesses

If there are multiple auditors of different branches of the same assessee, the auditor of the head office may rely on the reports of the branch auditors and submit his consolidated report (Refer para 15.7 read with para 14.6 of ICAI Guidance Note 2004). In case of assessee having multiple businesses with multiple auditors, there could be more than one tax audit reports. All the auditors will have to upload their respective reports which should be 'approved on-line' by the assessee.

CAG Report – Startling revelations

It is rather unfortunate that the Comptroller and Auditor General ('CAG') of India in his report No. 32 of 2014 has made critical observations on the overall performance of the auditors. He has pointed out various types of discrepancies on the part of the auditor. Some of the discrepancies pointed out are:

- The audits have been conducted in utterly careless manner. Certificates are issued in blatant disregard of all basic norms.
- In 367 cases surveyed there was a revenue loss of ₹ 2813 crores as a result of wrong audit reports. In many cases, CAs committed mistakes in calculating the exemptions / deductions, book profit u/s. 115JB, reporting on cash payments, etc.

This report is an eye opener for our CA fraternity. It emphasises the need for introspection. It is high time that we self-examine ourselves and improvise.

Further, Hon'ble Prime Minister's speech delivered on the occasion of CA Day was also worth taking seriously.

Code of Ethics of ICAI

In recent years there have been many complaints from the income tax department to the Council of ICAI against the erring CAs in respect of tax-audit. The auditor should bear in mind that the sanctity of reporting on Form 3CD is as much as that of reporting on accounts. One cannot afford to be less serious about it. The types of disciplinary cases in the context of tax audit are –

- Non communication with previous auditor and non-verification of payment of his undisputed audit fees
- Wrong contents of Form 3CD or non-reporting on certain items
- Lack, if not total absence, of documentation and working papers
- Signing more number of tax-audits than that permitted by ICAI
- Apart from the figures contained in the Form 3CD, discrepancies were also noticed in respect of the clauses pertaining to change in constitution of firm, method of accounting, change in business, etc.
- There are often disputes amongst the partners or directors. Hence, an auditor is well-advised to obtain the signatures of all the partners and directors as the case may be. There are instances where the disputing partners / directors disclaim the contents of the accounts or Form 3CD. They in turn file a complaint against the auditor. There could be specific clauses in the partnership deed that have a bearing on accounts or on the manner of signing. This is often lost sight of.

All such errors arise due to lack of application of mind and copy-paste approach. Professionals need to be more pro-active so as to avoid the last moment rush.

Management Representation Letter (MRL)

It is often observed that the auditors do not maintain proper working papers. The concept of peer-review is meant for curing this deficiency. One of the most important working papers is management representation letter. There are many points in the audit report for which MRL is absolutely essential since books of account may not reveal certain facts e.g., identification of related parties, contingent liabilities and assets, pending disputes and litigations, physical verification of assets, demands under other laws, (cess, property tax, labour laws, etc.). Just as there is a tendency to suppress profit for avoiding the taxes, sometimes there are also situations where profits are inflated for securing bank / institutional finance. Auditor has to be vigilant about both the aspects.

Conclusion

Chartered Accountancy is perhaps the only profession where members look upon their regulatory body namely ICAI for securing professional work to its members. The Government reposes increasing faith in the profession. Many times CAs have to act as an extended arm of the Government. It is the duty of the members to live up to the expectations of the society at large and also the Government in particular. We should ensure that the ICAI is not let down. It will be suicidal for the professionals to take the task of tax audit lightly.

In recent years the work opportunities for CAs have increased multifold. There is no need to succumb to the pressures of the client in the fear that he will go away. The respect and credibility of the profession is indeed its foundation. Any auditor would do well by constantly keeping this principle in mind. In this book all the writers have put in great efforts in dealing with the topics allotted to them.

I am sure this book will equip the tax auditor with the necessary knowledge and guidance to carry out the tax audits effectively and in time.

CA Anil Sathe

Applicability of Tax Audit under section 44AB

Introduction

The provisions of section 44AB have been on the statute book for more than three decades and yet the subject evokes considerable interest among professionals. It was introduced in 1984 as a process by virtue of which the accounts of a certain class of assessees crossing the threshold of turnover, gross receipts would be verified and opinion on their true and fair view would be expressed by the auditor. In addition thereto the auditor was required to verify the particulars in Form 3CD, and comment on their correctness. By way of subsequent amendments to Form 3CD far more responsibilities were assigned to the auditor. He was gradually required to express an opinion not only on the accounts but also on the particulars. The latest addition is the amendment requiring the auditor to verify whether the Income tax computation standards (ICDS), have been complied with. Since the subject" tax audit" is very old most of the issues have been discussed threadbare in various publications. The object of this article is only to revisit some important aspects and bring to the notice of the reader a few recent and emerging issues.

Testing the threshold

Every person, carrying on business and whose sales, turnover or gross receipt exceed ₹ 1 crore in any previous year, or is carrying on a profession and his gross receipts in the profession exceed 50 lakhs is required to get his accounts audited by an accountant before the specified date and furnish by that date the report of such audit in a prescribed form.

The terms, sales turnover and gross receipt which decide the applicability of the provision have been the subject matter of interpretation. Over a period of time the meaning of these terms is now well settled. In case of any doubt in regard to the terms, the Guidance note on tax audit published by the Institute of Chartered Accountants of India (ICAI) can be relied on. Since the threshold is tested for the purpose of deciding whether the accounts are to be audited or otherwise, the interpretation of these terms as adopted in the publication of the ICAI, should be followed, unless there is a compelling reason to take a different view.

Sales tax, VAT, and excise duty, are to be included in the definition of turnover. From 1st July the Goods and Services Tax (GST), replaces them. However since it is an indirect tax of the same nature and would be levied and disclosed in the sales bills/invoices, the same also should form part of turnover.

A common vexed issue is the determination of turnover in respect of derivative transactions. This is because the amount of the contract for a derivative does not represent delivery of the underlying share our securities. These contracts are settled by payment or receipt of differences. The Guidance Note of the ICAI takes a view that the favourable or unfavourable differences must be aggregated to find out the turnover.

Other issues like sales returns, trade discounts et cetera have been fully settled in course of time. If the person has multiple businesses these will have to be aggregated for the purpose of arriving at the total turnover of the person to determine applicability. However if a person is carrying on both business and profession then the limits applicable to business and profession will have to be considered separately. To illustrate if the turnover of a person's business is 80 lakhs and the receipts from the profession are 25 lakhs his accounts are not subject to tax audit.

Charitable and religious institutions

The taxation of charitable institutions has been the subject matter of substantial controversy, in the last few years. From assessment year 2009-10, by the insertion of the proviso any institution the objects whereof can be classified as being in the nature of "advancement of any other object of general public utility", and carries on an activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee, it is treated as not having a charitable purpose.

In such a case if the institution claims that it is not engaged in trade and commerce or business but the activity is intrinsic to its objects, in such a situation the said institution need not subject its accounts to a tax audit. Though the term "business", "trade" or" commerce" have a number of characteristics the intention to earn a profit must be one of them in the context of the provisions of section 2(15) read with section 44AB. The existence of such an intent or otherwise will always be the subject matter of significant debate. As stated above in the absence of such intent that trust would be able to urge that the provisions of section 44AB, would not apply. However if the entity desires to avoid any controversy whatsoever, then in such a situation it may subject its accounts to tax audit under section 44AB, and state that it is doing so as a matter of abundant caution and the conduct of a tax audit should not be construed as an admission that the entity is carrying on a business. In such a situation the books of the activity which is likely to be treated as a business by the department should be kept separately. This would then be in compliance the provisions of section 11(4A), enabling the entity to claim the exemption under section 11 should it be eligible.

If however, a business itself has been settled on the entity carrying on a charitable activity, in that case the provisions of section 11(4) would apply. Since the income of such a business has to be computed under sections 28 to 44, if the said business crosses the turnover threshold then in such a situation the trust would have to, subject the accounts of a business to tax audit under section 44 AB.

Corporate entities engaged in activities which can be classified as a profession

As has been, explained in the foregoing paragraphs there are different limits in respect of a business or profession for carrying out an audit under section 44AB. The limit for a business is ₹ 1 crore while for a profession it is 50 lakhs. Ordinarily a profession involves the use of structured knowledge and skills and the revenue earned is attributable to the exercise of such knowledge, skill or effort. Therefore normally such ventures are carried out in individual capacity or by firms. A firm is not an independent legal entity, though it may be an assessable one. The partners act for themselves as well as on behalf of the firm. In certain professions, the carrying on of a profession in an LLP structure is permitted.

However if a large number of resources, at times of diverse nature are required it is possible that an activity which has the characteristics of a profession, is carried out in corporate form. In such a situation the threshold limits applicable to a profession will apply.

Certain regulatory bodies do not permit the carrying on of a profession, or certain functions thereof in corporate form. This is because, the person carrying out a certification or authentication function is personally responsible, and in case of a dereliction of duty may be liable to some penal/disciplinary action by the regulator. For instance the audit /authentication function of a Chartered Accountant cannot be carried out in corporate form. A similar restriction applies to architects who certify or authenticate a building plans submitted to a regulatory authority.

Applicability to a working partner who is drawing remuneration above the threshold

Another area of litigation is whether when a partner of a firm, carrying on a profession receives remuneration in excess of the threshold limits whether his account is are liable to tax audit. While there are judicial pronouncements on either side of the spectrum, in my opinion the remuneration received by a partner is in the nature of special share of profits. This issue has been discussed in the decision of the apex court in Chidambaram Pillai's case. (106 ITR 292). The fact that such remuneration is taxed under the head profits and gains of business or profession will not make the remuneration receipts of profession in the context of 44AB. Consequently even if the remuneration is in excess of the prescribed limits a tax audit need not be carried out by the partner.

Presumptive taxation under sections 44AD and 44AB

Section 44AD, is a popular presumptive tax provision and its scope has been gradually enhanced over the years. Therefore all assessees save and except those carrying on profession as referred to in sub-section 44AA (1), a person earning income in the nature of commission or brokerage or a person carrying on agency business are eligible for the presumptive tax scheme, provided the total turnover or gross receipts are less than ₹ 2 crores. It has now been clarified that even if the threshold limit for tax audit is one crore, if an assessee whose turnover exceeds that limit adopts the presumptive tax scheme and declares income of the percentage specified or higher income no tax audit need be carried out. The benefit of the presumptive tax scheme is that an eligible assessee who declares the specified percentage of income or higher income is not required to maintain accounts, and the income declared is deemed to be his income from that business, and he is saved from the rigours of a scrutiny assessment.

The Finance Act, 2017 now provides that an assessee would have to adopt the presumptive tax scheme continuously. If in a particular year an assessee opts out of the scheme he would not be eligible to claim the benefit of such a scheme for a period of five succeeding years. Such a person would have to maintain accounts and have his accounts audited under section 44AB. Unfortunately both 44AD(4) and 44 AD(5) are not happily worded. The same are reproduced hereunder for ease of reference

Section 44AD……………….

[(4) ***Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the five assessment years relevant to the previous year succeeding such previous year not in accordance with the provisions of sub-section (1),*** *he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of sub-section (1).*

(5) ***Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee to whom the provisions of sub-section (4) are applicable*** *and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB.]*

* Emphasis supplied by me

An example will illustrate the lacuna in drafting. Let us take the case of an assessee who commences his business during the previous year 2016-17, relevant to assessment year 2017-18 and has a turnover of 80 lakhs. He declares a profit of 5% thereof which is four lakhs. The provisions of 44AD(4), cannot apply to him because the said provision contemplates an eligible assessee declaring profits in accordance with the provisions of section 44AD, and thereafter declaring profits not in accordance with this section. Once the provisions of section 44AD(4), do not apply the provisions of section 44AD(5) can also not apply. If one reads the provisions literally then such a person will not have to conduct a tax audit of his accounts which does not appear to be the intent.

44ADA and section 44AB

Finance Act, 2017 has expanded the ambit of the presumptive tax provisions to professionals. Any assessee who is a resident of India who is engaged in a profession referred to in sub-section (1) of section 44AA, and whose gross receipts do not exceed 50 lakhs will be entitled to the benefit of such presumptive tax provision, if he declares a profit of 50% or higher of his gross receipts. Such a person will not be required to maintain accounts, and consequently there would be no requirement of audit under section 44AB.

Unlike the restrictive provisions in 44AD, it is not mandatory for a profession and to adopt the presumptive tax provisions continuously.

Conclusion

The subject of tax audit continues to throw up a number of controversies. Over a period the duty of a tax auditor has become more onerous. It is advisable to tread with caution while carrying out the assignment of a tax audit. It is necessary adopt a conservative approach, and where the auditee, does not concur with the tax auditor's interpretation of a particular provision an appropriate disclaimer or disclosure as applicable should be mentioned in the tax audit report.

CA Himanshu Kishnadwala

Applicability of Accounting Standards/ Standards of Auditing for Non-corporate entities

Importance of Accounting Standards

Accounting Standards may be defined as a principle that governs accounting practice and that is used as a reference to determine the appropriate treatment of transactions. Accounting Standards are a selected set of accounting policies or broad guidelines regarding the principles and methods to be followed for accounting and preparation of financial statements.

The need for Accounting Standards arose because of prevalence of wide variety of accounting methods in use, making it difficult for the users of the Accounts for its evaluation. Recognising the need to harmonise the diverse accounting policies and practices followed, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) issues Accounting Standards (AS) from time to time. The objective of formulating AS is to ensure that the financial statements of the enterprises that follow them are comparable and that they are true and fair. The AS establish rules relating to recognition, measurement and disclosures and play a very vital role in preparation of Financial Statements. While formulating the AS, ASB takes into account the applicable laws, customs, usages and business environment.

Status of Accounting Standards

ICAI has so far issued 28 AS (AS 1 to AS 29 and excluding AS 8 which was withdrawn). For corporate entities, the AS issued by ICAI are finally notified by National Advisory Committee on Accounting Standards (NACAS). For non-corporate entities, however, the AS issued by ICAI are relevant. With a view to harmonise the AS so far issued by it with those notified by NACAS for corporate entities, ICAI, in August 2016, decided to carry out appropriate changes in the AS issued by it. As per the said announcement of ICAI in August 2016, the amended AS would be applicable for accounting periods commencing on or after April 1, 2017. As per the said announcement, AS 6 on 'Depreciation Accounting' was withdrawn and the same Standard with certain modifications is incorporated in AS 10 "Property, Plant and Equipment". With the above, the AS applicable to non-corporate entities shall be 27 in aggregate. For the year ended 31st March 2017, the AS applicable would be those prior to the August 2016 announcement of ICAI. The list of AS applicable to non-corporate entities for the financial years 2016-17 and 2017-18 onwards is given at **Annexure I**.

Exemptions / relaxations for SMEs

Considering the rigours of following AS, the ICAI granted exemption and made certain relaxations for Small and Medium Enterprises (SMEs). Accordingly,

- All enterprises are classified into three categories, viz., Level I, Level II and Level III. Level II and Level III enterprises are considered as SMEs. The criteria for different levels are given in **Annexure II**.
- Level I enterprises are required to comply fully with all AS.
- With respect to Level II and Level III enterprises no relaxation is given *qua* the recognition and measurement principles. Relaxations are provided with regard to disclosure requirements. Accordingly, Level II and Level III enterprises are fully exempted from certain AS which primarily lay down disclosure requirements. In respect of certain other AS, which lay down recognition, measurement and disclosure requirements, relaxation from certain disclosure requirements are given. Details of exemptions and relaxations are given in **Annexure III**.

Income Computation and Disclosure Standards (ICDS)

The Central Board of Direct Taxes has also notified 10 ICDS which have come into force from 1st April, 2017, i.e., assessment year 2017-18, and would apply to all assessees (other than an individual or an HUF not required to get his/its accounts audited under section 44AB) following mercantile system of accounting for the purposes of computation of income chargeable to income tax under the head "Profits and gains of business or profession" or "Income from other sources".

Thus, it would be noted that the ICDS are to be followed only for the purposes of computation of income chargeable to income tax. The ICDS need not be applied for preparation and presentation of financial statements.

Details of ICDS and its reporting in Form 3CD is covered elsewhere in this journal.

Whether Accounting Standards are binding in nature for non-corporate entities?

It may be observed that the AS, as such, are not binding on the non-corporate entities. This is so because, unlike the Companies Act, 2013, none of the regulations which may be governing such entities, statutorily provide for adherence to such standards in the preparation and presentation of their financial statements. As mentioned above, the notified ICDS also are only for the purposes of computation of income chargeable to income tax and the entities are not obliged to prepare their accounts as per ICDS.

However, the Chartered Accountants, who audit the accounts of such entities are duty bound to ensure that the AS are implemented in the preparation and presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, he is duty bound to make adequate disclosures in their reports so that the users of such financial statements may be aware of such deviations. If he fails to report on such non-compliance, he will be exposed to the disciplinary jurisdiction of the ICAI under clause (9) of Part I of the Second Schedule of Chartered Accountants Act, 1949, as it will be considered as "failure to invite attention to any material departure from the generally accepted procedure to audit".

Method of Accounting followed other than 'accrual'

As per the Announcement of the ICAI of August 1994, where there are no statutory requirements for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual', the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case auditor should also examine whether those provisions of the AS which are applicable in the context of the basis of accounting followed by the entity have been complied with or not and consider making suitable disclosures / qualifications in his audit report accordingly.

Common cases of non-compliance with Accounting Standards

In the case of non-corporate entities who are not as organised as a large corporate entity, cases of non-compliance with AS by such entities do occur. Also, those cases of non-compliance may be unintentional. However, the consequence thereof could result into financial loss for the entity (e.g., interest / penalty for concealment of income) or disciplinary action against the member of the ICAI. The Financial Reporting Review Board (FRRB) of ICAI has observed the following common cases of non-compliance with AS (given here as applicable to non-corporate entities):

i. **AS 1 - Disclosure of Accounting Policies**
- Where fundamental accounting assumptions viz., going concern, consistency and accrual, are not followed, the fact thereof is not disclosed.
- Accounting policies are given under various notes to accounts instead of stating all such policies under a single head of significant accounting policies.
- Accounting policy for recognition of income from sources, amount of which is significant, is not given.
- Although the policies state the value at which revenue is recognised, it omits to state explicitly the point of time when significant risk and rewards in goods stand transferred to the buyer and is recognised in the books of account.

ii. **AS 2 – Valuation of Inventories:**
- Inventories valued without considering the net realizable value.
- Cost formula for valuing the inventory not disclosed.
- Inventories described "as taken, valued and certified by the management" giving the impression that the auditor merely relied on the certificate.
- Usage of average cost method instead of weighted average method.
- Costs like indirect overheads, depreciation, excise duty, although incurred for converting material into finished goods, not considered.
- Cost of inventory included finance cost and administrative cost.

iii. **AS 4 - Contingencies and Events Occurring After the Balance Sheet Date**
- Net worth of the debtor party had eroded and the party was incurring loss, yet provision for loss not made.

iv. **AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies**
- Nature and amount of prior period item not mentioned. It was merely stated that the same have been adjusted in respective heads of income and expenditure.
- Impact on the financial statements due to revision of depreciation rate not given.

v. **AS 6 - Depreciation Accounting**
- Method of charging depreciation is disclosed, but rate at which depreciation provided not disclosed.
- Leasehold land is not amortised over its lease period.
- Effect of change in the accounting policy of depreciation not quantified and disclosed.

vi. AS 7 - Construction Contracts

- 'Percentage of Completion Method' is described as 'Proportionate completion method'.
- Recognition of revenue based on the running bill raised and approved, which may not necessarily reflect the percentage of work completed.

vii. AS 9 - Revenue Recognition

- Reporting sales net of excise duty or gross sales with excise duty shown separately as expenditure item in Profit and Loss account.
- Sales tax and VAT collected on sales not excluded from the amount of sales.
- Consignment sales also included in sales.
- Foreign exchange fluctuation adjusted against gross sales / export sales.
- Receipts from duty drawback, licence premium on exports, etc. included in sales amount.
- Goods captively consumed included in sales.

viii. AS 10 - Accounting for Fixed Assets

- Cost of fixed assets to include only those cost which can be attributed to bring the asset to its working condition for its intended use and would not include cost incurred thereafter, even though the commercial production has not commenced.

ix. AS 11 - The Effects of Changes in Foreign Exchange Rates

- Premium in respect of forward exchange contract is charged to profit and loss as and when the contracts are entered instead of amortising the premium over the life of the contract.
- Profit or loss on forward exchange contract is recognised only on settlement of the contract. It is not recognised in each of the reporting year, based on foreign currency rate as at the balance sheet date.
- Gain or loss arising from Foreign exchange fluctuation *qua* the debtors and creditors adjusted against amount of sales and purchases instead of disclosing separately in the profit and loss account.
- Transactions relating to purchases and sales translated at the rate prevailing at the time of settlement of the transactions.

x. AS 12 - Accounting for Government Grants

- Sales tax subsidy is basically a Government grant and the entity is required to disclose accounting policy as adopted by it for recognition of the same.

xi. AS 13 - Accounting for Investments

- Dividend income, interest income and profit on sale of investment from long term and current investment is required to be shown separately.
- Provision for diminution, other than temporary, in the value of long term investment not made.
- Current investments are required to be carried at the lower of cost or fair value determined either on an individual investment basis or by category of investment basis but not on an overall (or global) basis.

xii. AS 15 – Employee Benefits

- Gratuity liability provided only in respect of those employees who have completed five years of service.

- Liability on account of gratuity and leave encashment provided on the basis other than actuarial valuation.

xiii. **AS 16 - Borrowing Costs**

- Amount of borrowing cost capitalised during the year is not disclosed in the financial statements.
- Premium on pre-payment / resetting of interest liability on term loans wrongly amortised over the remaining repayment period of term loans.

xiv. **AS 18 - Related Party Disclosures**

- All transactions with related parties required to be disclosed rather than disclosing only significant transactions.
- Name of related parties and nature of relationship, where control exists, is required to be disclosed irrespective of whether or not there have been transaction between the related parties.
- Where material transactions have taken place with the related parties, the party-wise disclosure is necessary.
- Complete disclosure of the volume of the transactions as well as outstanding balance and provision for doubtful debts due from such parties not given.
- Amount reported as outstanding without stating whether such amount is a debit balance or credit balance.

xv. **AS 19 – Leases**

- The Standard does not apply to lease agreements to use land.

xvi. **AS 22 - Accounting for Taxes on Income**

- Deferred tax liabilities to be disclosed after the head 'Unsecured loans' and deferred tax assets after the head 'Investments'.
- Provision for current tax and deferred tax have been clubbed and disclosed under the single head of 'Provision of taxation' in Profit and Loss Account.
- The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances not disclosed.
- Provision for taxation and Advance tax paid not set-off against each other.
- Deferred tax assets and deferred tax liabilities both were shown simultaneously on the assets and liabilities side of the Balance sheet (instead of netting off both against each other).

xvii. **AS 26 - Intangible Assets**

- Expenditure on research and development phase should be classified as expenditure on Research phase and expenditure on Development phase, instead of classifying them on the basis of their nature viz., revenue and capital expenditure.
- The expenditure on research phase should be expensed as and when incurred and the expenditure on Development phase should be capitalized, if and only if, such expenditure meets the conditions laid down in the Standard.

xviii. **AS 28 - Impairment of Assets**

- Statement of Accounting policy should give policy on impairment.

xix. **AS 29 - Provisions, Contingent Liabilities and Contingent Assets**

- The entity is required to disclose the carrying amount at the beginning and end of the period, additional provision made during the year, amount incurred and charged against the provision and the unused amount reversed during the year.

Applicability of Standards on Auditing

The nature of audit of the non-corporate entities is similar to that of audit of general purpose financial statements. Hence, the same audit procedures as prescribed under Standards on Auditing ('SAs') issued by the ICAI shall be applicable. Thus, the auditor is expected to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. Though all the 45 SAs issued by ICAI would need to be followed by the auditor, special attention is drawn to the following SAs which would be relevant for audit of non-corporate entities:

- <u>SA 210 – Agreeing the Terms of Audit Engagements:</u> The auditor should agree the terms of the audit engagement with management and record so in engagement letter.
- <u>SA 230 – Audit Documentation:</u> An audit under say the Income Tax Act, 1961 is also an Attestation Engagement, and thus is covered by the Statement of Peer Review. Therefore, adequate documentation for the same is necessary.
- <u>SA 250 - Consideration of Laws and Regulations in an Audit of Financial Statements:</u> The entity may have been constituted under different laws and different laws may be applicable to such entity. Though the auditor is not required to verify or certify about the compliance with the provisions of such other laws, however, if such non-compliance can lead to the contravention of the provisions affecting the fundamental assumption based on which the Accounts have been drawn, or truth and fairness thereof, then it is the duty of the auditor to verify the compliance thereof.
- <u>SA 580 – Written Representations:</u> The auditor should also obtain written representations as audit evidence from the management of the entity.

Audit Report

While issuing his Audit Report, the Auditor is required to comply with following SAs:

- SA 700 – Forming an Opinion and Reporting on Financial Statements;
- SA 705 – Modification to the Opinion in the Independent Auditor's Report - where the Audit opinion is either a qualified or adverse or a disclaimer.
- SA 706 – Emphasis of Matter Paragraphs and Other Matter Paragraph in the Independent Auditor's Report - where the auditor desires to draw user's attention to an important matter in the financial statements.

For non-corporate entities, the audit reports are normally issued in the formats prescribed by the applicable statute. For example, for audits u/s. 44AB of the Income Tax Act, 1961 the reports are to be issued in Form 3CB. Form 3CB, however does not contain all clauses as in SA 700, etc. Hence, a doubt had arisen whether Form 3CB has to be modified to also include the clauses of SA 700. In this context, ICAI has, *vide* its Announcement in July 2013, permitted members to submit the audit report in the format prescribed under the relevant law or regulation and has clarified that the same would not be viewed as having not been complied with the provisions of SA 700. Thus, issuing the Audit Report in Form 3CB would be considered as having been issued in compliance with the above Standards on Auditing.

Conclusion

As can be seen from the above, it would be preferable for non-corporate entities to also comply with the AS (especially the recognition and measurement standards), else the auditors will have to issue a modified report. The auditors will also have to comply with all the SAs else they may face action by ICAI for inadequate procedures followed for the conduct of the audit.

Annexure I

I. List of Accounting Standards:

- AS 1 - Disclosure of Accounting Policies
- AS 2 - Valuation of Inventories*
- AS 3 - Cash Flow Statements
- AS 4 - Contingencies and Events Occurring After the Balance Sheet date*
- AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 6 - Depreciation Accounting (not applicable to accounting periods commencing on or after April 1, 2017)
- AS 7 - Construction Contracts
- AS 9 - Revenue Recognition
- AS 10 - Accounting for Fixed Assets* (Title of the Standard changed to Property, Plant and Equipment from April 1, 2017)
- AS 11 - The Effects of Changes in Foreign Exchange Rates
- AS 12 - Accounting for Government Grants
- AS 13 - Accounting for Investments*
- AS 14 - Accounting for Amalgamations* #
- AS 15 - Employee Benefits
- AS 16 - Borrowing Costs
- AS 17 - Segment Reporting
- AS 18 - Related Party Disclosures
- AS 19 - Leases
- AS 20 - Earnings Per Share
- AS 21 - Consolidated Financial Statements* #
- AS 22 - Accounting for Taxes on Income
- AS 23 - Accounting for Investments in Associates in Consolidated Financial Statements #
- AS 24 - Discontinuing Operations
- AS 25 - Interim Financial Reporting
- AS 26 - Intangible Assets
- AS 27 - Financial Reporting of Interests in Joint Ventures #
- AS 28 - Impairment of Assets
- AS 29 - Provisions, Contingent Liabilities and Contingent Assets*

Note: (*) Revised Standard applicable in respect of financial statements for the accounting periods commencing on or after April 1, 2017.

(#) Not applicable to non-corporate entities

Annexure II

Criteria for classification of enterprises:

Level I Enterprises:
Enterprises which fall in any one or more of the following categories, at any time during the accounting period, are classified as Level I enterprises:

i. Enterprises whose equity or debt securities are listed, whether in India or outside India.

ii. Enterprises which are in the process of listing their equity or debt.

iii. Banks including co-operative banks.

iv. Financial institutions.

v. Enterprises carrying on insurance business.

vi. All commercial, industrial and business enterprises, whose turnover for the immediately preceding accounting period exceeded ₹ 50 crores.

vii. All commercial, industrial and business enterprises having borrowings in excess of ₹ 10 crores.

viii. Holding and subsidiary enterprises of any one of the above.

Level II Enterprises
Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

i. All commercial, industrial and business enterprises, whose turnover for the immediately preceding accounting period exceeded ₹ 40 lakhs but not exceeding ₹ 50 crore.

ii. All commercial, industrial and business enterprises having borrowings in excess of ₹ 1 crore but not in excess of ₹ 10 crore at any time during the accounting period.

iii. Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

Level III Enterprises
Enterprises which are not covered under Level I and Level II are considered as Level III enterprises.

Additional Requirements:

i) An entity which does not disclose certain information pursuant to the above exemptions / relaxations, should disclose the fact that it is an SME and has complied with the AS in so far as they are applicable to entities falling in Level II or Level III, as the case may be;

ii) Where an entity has previously qualified for any exemption / relaxation (being under Level II or Level III), but no longer qualifies for the relevant exemption / relaxation in the current accounting period, the relevant standards / requirements become applicable from the current period. However, the corresponding previous period figures need not be disclosed.

iii) Where an entity has been covered in Level I and subsequently, ceases to be so covered, the entity will not qualify for exemption / relaxation available to Level II enterprises, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level II and subsequently, gets covered under Level III.

iv) If any entity covered under Level II or Level III opts not to avail of the exemption or relaxations available to that level of entities in respect of any but not all of AS, it should disclose the Standard(s), in respect of which it has availed the exemption or relaxations.

v) If an entity covered in Level II or Level III desires to disclose information not required to be disclosed pursuant to the exemptions or relaxations available to that Level of entities, it should disclose that information in compliance with the relevant AS.

vi) An entity covered in Level II or Level III may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in AS.

Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

Annexure III

I. <u>Accounting Standards applicable to all enterprises in their entirety (Levels I, II and III)</u>:

- AS 1 - Disclosure of Accounting Policies
- AS 2 - Valuation of Inventories
- AS 4 - Contingencies and Events Occurring After the Balance Sheet date
- AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 6 - Depreciation Accounting (not applicable to accounting periods commencing on or after April 1, 2017)
- AS 7 - Construction Contracts
- AS 9 - Revenue Recognition
- AS 10 - Accounting for Fixed Assets (Title of the Standard changed to Property, Plant and Equipment from April 1, 2017)
- AS 11 - The Effects of Changes in Foreign Exchange Rates
- AS 12 - Accounting for Government Grants
- AS 13 - Accounting for Investments
- AS 14 - Accounting for Amalgamations
- AS 16 - Borrowing Costs
- AS 22 - Accounting for Taxes on Income
- AS 26 - Intangible Assets

II. <u>Exemptions/Relaxations for SMEs</u>:

(A) Accounting Standards not applicable to Level II enterprises in their entirety:

- AS 3 - Cash Flow Statements
- AS 17 - Segment Reporting

(B) Accounting Standards not applicable to Level III enterprises in their entirety:

- AS 3 - Cash Flow Statements
- AS 17 - Segment Reporting
- AS 18 - Related Party Disclosures
- AS 24 - Discontinuing Operations

(C) Accounting Standards not applicable to all non-corporate entities:

- AS 21 - Consolidated Financial Statements
- AS 23 - Accounting for Investments in Associates
- AS 27- Financial Reporting of Interests in Joint Ventures.

(D) Accounting Standards in respect of which relaxations from certain disclosure requirements have been given to non-corporate entities falling in Level II and Level III enterprises:

i. AS 15 – Employee Benefits

Exemptions / relaxations are available under two sub-classifications viz., (a) entities whose average number of persons employed during the year is 50 or more; and (b) entities whose average number of persons employed during the year is less than 50.

ii. AS 19 – Leases

Paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37(a) and (f); and 46(b) and (d) relating to disclosures are not applicable to non-corporate entities falling in Level II.

Paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37(a), (f) and (g); and 46(b), (d) and (e), of AS 19 relating to disclosures are not applicable to Level III entities.

iii. AS 20 - Earnings Per Share

Diluted earnings per share and information required by paragraph 48(ii) is not required to be disclosed.

iv. AS 28 - Impairment of Assets

Non-corporate entities are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique. Further, such an entity need not disclose the information required by paragraph 121(g) of the Standard.

v. AS 29 - Provisions, Contingent Liabilities and Contingent Assets Paragraphs 66 and 67 are not applicable to entities falling in Level II and Level III.

CA Meghana Chheda

ICDS – Fine tuning & Disclosure

Background

Section 145 of the Income-tax Act, 1961 (Act) provides that income chargeable under the head "Profits and gains of business or profession" (Business) or "Income from other sources" (Other sources) should be computed as per cash or mercantile system of accounting regularly followed by the taxpayer. Thus, ordinarily, income for tax purposes is to be computed in accordance with the commercial accounting principles, unless such principles are superseded or modified by legislative enactments and this is where s. 145(2) comes into play (refer Supreme Court in the case of *CIT vs. Woodward Governor India (P) Ltd. (2009) 312 ITR 254 (SC))*. In relation thereto, s. 145(2) of the Act empowers Central Government (CG) to notify from time-to-time income computation and disclosure standards (ICDS) to be followed by any class of taxpayers or in respect of any class of income.

Based on recommendations of the Expert Committee on ICDS (Committee) and public consultation on the draft ICDS, the CG had exercised its powers u/s. 145(2) and notified[1] 10 ICDS from financial year (FY) 2015-16. After duly considering the hardships faced by the stakeholders and their concerns on ICDS implementation, the Committee recommended a two-fold approach for smooth implementation thereof viz., (a.) Amendment to the ICDS provisions and (b.) Issue of clarifications, in the form of FAQs. The CG accepted the aforesaid recommendations and notified revised ICDS applicable for the first time from FY 2016-17 onwards[2]. It also modified the Form 3CD for including ICDS related disclosure requirements and quantifying adjustment to profits or loss for complying with ICDS. ICDS apply to all the taxpayers following the mercantile system of accounting and for computing income under the heads "Business" or "Other Sources". However, as a relaxation measure, they do not apply to individuals or HUFs who are not liable for tax audit u/s. 44AB of the Act. The CBDT also issued Circular No. 10/ 2017 dated 23rd March 2017 (Circular) providing clarifications in the form of FAQs on 25 issues. While some of the clarifications are welcome, there are certain issues which still remain unresolved and have created further uncertainty. In this regard, one may keep in mind the well-settled principle of law that Circulars are binding on taxpayers only to the extent beneficial.

Recently, Writ Petition[3] filed by The Chamber of Tax Consultants challenging the issuance of ICDS is pending before the Delhi High Court and the

1 Refer Notification No. 32/2015 dated 31st March, 2015

2 Refer Notification No. 87/2016 dated 29th September, 2016 & Notification No. 86/ 2016 which rescinded the old ICDS

3 The Chamber of Tax Consultants vs. Union of India (W.P No. (C) 5595/2017)

matter has been fixed for hearing on 2th August 2017. Thus, taxpayers will need to wait and watch for the outcome of the Writ Petition. Till then assuming that ICDS is here to stay, various issues would crop up in the minds of taxpayers while filing their tax returns as also tax professionals at the time of signing tax audit reports of their clients for FY 2016-17, being the first year of ICDS compliance. While notified ICDS are largely based on accounting standards issued by the ICAI (AS), this article aims to identify and discuss certain common cases of likely deviation between policies followed in accounts and requirements under ICDS and also to clear air on certain fundamental issues arising on application of ICDS.

Non-applicability of ICDS to certain categories of taxpayer

Partnership firms and other small taxpayers such as retailers, doctors, advocates, etc. following cash system of accounting are outside the scope of ICDS. Also, ICDS do not apply to individuals and HUFs who are not liable to tax audit u/s. 44AB of the Act. While tax audit does not apply even in case of those taxpayers who are governed by presumptive tax provisions such as s. 44AD, 44ADA, 44B, 44BB etc., there is no specific scope exclusion for them. FAQ 3 of the Circular clarifies that ICDS applies even where income is computed under presumptive tax scheme such as s. 44AD where the provisions of ICDS III/ IV shall apply for determining receipts or turnover, as the case may be. However, in case of other provisions, presumptive income is worked out on the basis of "amount paid/ payable or received/ deemed to be received" by the taxpayer. In the context of s. 44BB, judicial precedents have also upheld that s. 44BB is a complete or separate code in itself providing for a legal fiction and thus, normal provisions governing scope of income as per s.2(24) r.w. s. 4/5/9 are not relevant (refer, *CIT vs. ONGC (2002) 255 ITR 413 (Rajasthan), Ensco Maritime Ltd. vs. Addl. CIT (2017) 244 Taxman 261 (Uttarakhand)).* Accordingly, ICDS should not apply to taxpayers governed by such presumptive tax schemes which do not involve computation of tax on the basis of gross receipts or turnover etc. The ICAI's technical guide on ICDS also takes a similar view.

Certain cases of likely deviation between accounting policies and requirements under ICDS, including disclosure requirements

Fundamental principles

S. 145, being a computational provision, does not authorise the CG to alter the scope and ambit of total income. What is chargeable under the Act is "income" and such income can be taxed only when it has accrued in accordance with the charging provisions of s. 4 and 5 of the Act. In *CIT vs. Excel Industries Ltd (2013) 358 ITR 295 (SC),* the Supreme Court after referring to various decisions laid down the following three tests to determine the "accrual" of income:

a) Whether the income accrued to the assessee is real or hypothetical;
b) Whether there is a corresponding liability of the other party to pay the amount;
c) Whether there is a realistic probability of realisation of the amounts by the assessee.

Though ICDS seeks to blur the above principles by leading to acceleration of income in various cases, taxpayers may be able to successfully contend that if income has not accrued as per the above principles, ICDS has no role to play being a delegated legislation. In fact, the Chamber of Tax Consultants has been in the forefront by taking a pro-active measure of filing a Writ Petition before the Delhi High Court challenging, *inter alia,* issuance of ICDS. Considering the fact that compliance of ICDS would arise at the time of filing tax returns for this year, the matter is fixed for hearing on 28th August, 2017. Thus, taxpayers will need to keep a tab on the outcome of the Writ Petition. Nonetheless, if ICDS still continues to apply, taxpayers should keep following hierarchy in mind:

a) Specific statutory provisions (Act)
b) Income tax rules

c) Real income theory

d) Tax jurisprudence on above

e) ICDS

f) Commercial principles of accounting

The above discussion is equally relevant even after issuance of FAQ 2 of the Circular which states that certain judicial rulings were pronounced in absence of authoritative guidance on these issues under the Act and hence, ICDS seeks to provide certainty to these issues. ICDS being only a method for computation of taxable income may override those judicial precedents which deal with the method of accounting regularly employed by the taxpayer. However, to the extent of conflict with scope and ambit of 'total income', the Circular may be regarded as deviating from correct legal position and not binding on the taxpayers – unless, of course, if the taxpayer seeks tax treatment as per ICDS and Circular which is favourable to it (e.g. recognition of MTM loss on capital monetary items as per ICDS VI). Certain common cases of deviation *qua* each ICDS are highlighted below:

ICDS I on accounting policies

ICDS I requires disclosure of all significant accounting policies followed by the taxpayer. In case of change in accounting policy for a reasonable cause, disclosure is required not only in the year of change but also in the year in which such change has material impact for the first time (i.e. when there is no material impact in the year of change). This results in enhanced disclosure requirement and compliance burden for the taxpayers since they will need to keep track of changes in accounting policy if no material impact arises in the year of change and disclose the impact of change in the relevant subsequent year.

ICDS II on inventories

By and large, since provisions of AS-2 have been imported into ICDS II, disclosure requirements for policies followed in books of account in relation to inventory and for tax computation may not be materially significant. However, under ICDS II, the cost of inventory includes duties, taxes etc. even if they are subsequently recoverable from tax authorities whereas inventory valued as per AS-2 does not include such duties, taxes etc. As per s. 145A which is notwithstanding s. 145 including ICDS, inventory is to be valued as per the method of accounting regularly followed by the taxpayer and further adjusted to include all taxes, duty, cess etc. Thus, taxpayer will need to value inventory as per inclusive method and disclose the same in Form 3CD. Existing clause 14(b) of Form 3CD also requires disclosure of deviation in the method of closing stock valuation employed by the taxpayer and the valuation method prescribed by s. 145A including its effect thereof on the profit or loss.

ICDS III on construction contracts

Retention money: Unlike AS-7, ICDS III specifically provides that retention money shall form part of contract revenue thereby requiring recognition of such retention money as income under Percentage of Completion Method (POCM), even if related performance conditions are yet to be satisfied. In relation thereto, taxpayer needs to disclose the amount of contract revenue recognised as revenue for the period. In such a scenario, if taxpayer adopts a view that retention money does not 'accrue'/ become 'due' for tax purposes pending satisfaction of performance criterion, it will need to make a specific disclosure in its Form 3CD stating the reason for such non-recognition of retention money even when ICDS specifically provides for inclusion of retention money as part of contract revenue. Sample disclosure as per ICDS III may be given as under in Form 3CD:

> *"Taxpayer has adopted a position that retention money is not to be recognised as contract revenue since it does not become 'due' to the taxpayer in absence of satisfaction of relevant performance conditions and legal right to receive income. Reliance has been placed on various judicial precedents (illustratively ….) for adopting such a view. Accordingly, above figure of contract revenue recognised as revenue for the period does not include the amount of retention money."*

Foreseeable loss: Under AS-7, if it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. However, ICDS III provides that expected losses shall be allowed only in proportion to the stage of completion. Thus, the amount of recognised profits (less recognised losses) up to the reporting date under ICDS in Form 3CD III shall be different as compared to where the taxpayer has recognised entire foreseeable loss as an expense in its books of account.

Disclosure of grandfathered contracts: ICDS III grandfathers past contracts existing as on 31st March 2016 i.e. construction contract which has "commenced" on or before 31st March, 2016 but not completed by that date shall be recognised based on the method regularly followed by the taxpayer prior to 1st April, 2016. However, any new contract "commenced" on or after 1st April, 2016 shall be recognised in accordance with ICDS III i.e. as per POCM method. Since existing contracts as on 31 March 2016 have been grandfathered from the computation provisions of ICDS III, disclosure requirements prescribed under ICDS III apply only to new contracts whose treatment is governed by ICDS III provisions. Nevertheless, it may be better to disclose this fact explicitly in its Form 3CD, illustratively as under:

> *Particulars pertaining to the contracts which have been commenced prior to 31st March, 2016 have not been disclosed since they are recognised as per the method of accounting regularly followed by the taxpayer and not in accordance with the provisions of ICDS III.*

Aforesaid transitional provisions and disclosure requirements equally apply in case of service contracts dealt specifically by ICDS IV.

ICDS IV on revenue recognition

ICDS IV provides that for tax purposes, interest shall accrue on time basis with respect to the amount outstanding and the rate applicable. The test of reasonable certainty of ultimate collection for revenue recognition applies only to sale of goods and rendering of services and not to interest, royalty and dividend incomes. FAQ 13 of the Circular reiterates that interest accrues on time basis and subsequent non recovery, if any, can be claimed as deduction under second proviso to s. 36(1)(vii). However, if taxpayer still wishes to claim such interest income on 'due' basis relying on jurisprudence on real income theory, appropriate disclosure in Form 3CD will be desirable. Though there is no specific requirement under ICDS IV to disclose policy for recognition of interest income, ICDS I requiring disclosure of all 'significant' accounting policies may necessitate disclosure for such non-recognition of interest income on time basis.

ICDS V on tangible fixed assets

Disclosure requirements under ICDS V in relation to tangible fixed assets are similar to clauses 18 (a) to (f) in Form 3CD and hence, there is no disclosure impact of ICDS V to that extent.

ICDS VI on foreign exchange differences

ICDS VI dealing with foreign currency transactions, translation of financial statements of foreign operations and treatment of forward exchange contracts is subject to the provisions of s. 43A and Rule 115. Revised ICDS IX has removed the distinction between integral and non-integral foreign operations and provides for a common treatment for all foreign operations in line with treatment applicable to similar items of head office. As per AS-11, taxpayers having non-integral foreign operations park exchange differences in the Foreign Currency Translation Reserve (FCTR) and generally transfer it to P&L A/c in the year of disposal of foreign operation. FAQ 16 of the Circular clarifies that FCTR balance as on 1st April, 2016 pertaining to monetary items shall be recognised in accordance with ICDS VI in FY 2016-17 to the extent not recognised in the income computation in the past. This will result in upfront taxation of FCTR balance (restricted to monetary items) in FY 2016-17 and taxpayers will also have practical challenge of pulling out break up of FCTR between monetary and non-monetary items right from the first year in which such FCTR was created.

Under well-settled principles of tax jurisprudence, forex differences pertaining to capital items like loans borrowed for fixed assets (not covered by s. 43A) are not allowed as deduction being capital in nature. However, ICDS VI does not distinguish between capital and revenue monetary items. This results in a situation where taxpayers can seek revenue treatment for capital monetary items (which is not covered by s.43A). On the other hand, taxpayers who find revenue treatment as per ICDS VI disadvantageous may claim that ICDS cannot override the settled positon of distinction between capital and revenue items under the Act. But both taxpayers will need to be consistent across different years and make appropriate disclosures in Form 3CD.

ICDS VII on government grants

Transitional provision of ICDS VII provides that Government grant which meets the recognition criteria on or after 1st April, 2016 shall be recognised in accordance with ICDS VII. FAQ 17 of the Circular clarifies that all Government grants actually received prior to 1 April 2016 shall be deemed to have been recognised on its receipt in accordance with para 4(2) of ICDS VII and will be outside the scope of ICDS VII. Such grants shall continue to be recognised as per the law prevailing prior to that date even if some of the related conditions are met on or after 1st April, 2016.

However, this raises an issue on taxation of grants received post 1st April, 2016 but related conditions whereof are met in a future year. In such a situation, whether such grant is taxable in the year of receipt or in the year of perfected entitlement i.e. year in which related conditions are met? As per FAQ, such grant is taxable in the year of receipt since para 4(2) provides that recognition shall not be postponed beyond the date of actual receipt. Incidentally, this may give rise to MAT mismatch if the grant is recognised as income in books by credit to P&L in a later year when related conditions are met. Para 4(2) needs to be read along with paras 5 to 9 of ICDS VII which lay down the treatment of Government grants and accordingly, such grant will be taxable in the year of perfected entitlement. ICDS being a method of computation cannot create a charge ahead of perfected entitlement and enforceable debt due in favour of the taxpayer. Thus, along with the disclosure for nature and extent of Government grants recognised during the year as income or by way of reduction from the actual cost of assets, taxpayer will also need to specifically mention the amount of Government grants not recognised and the reasons thereof in Form 3CD.

ICDS VIII on securities

ICDS VIII applicable in case of securities held as stock-in-trade, provides for 'category wise'/ 'bucket' approach of valuation of securities as against individual 'scrip wise' valuation which is normally followed for accounting purposes. In view of conflict between book treatment and ICDS, s.145A being a specific provision for valuation of inventory, overrides s. 145 including ICDS VIII. The term 'inventory' is a neutral term which can include securities are held as stock-in-trade. This is supported by scope exclusion provided in para 1(c) of AS-2 / para 1(c) of ICDS II which excludes shares, debentures and other financial instruments held as stock-in-trade. But for such exclusion, relevant AS-2 / ICDS II would have applied to valuation of securities held as inventory as well. Hence, book treatment for securities held as stock-in-trade subject to inclusion of statutory levies as per s.145A shall be relevant for tax purposes notwithstanding anything to the contrary contained in ICDS VIII. But since the definition of 'goods' as per The Sale of Goods Act, 1930 includes 'shares' but excludes other securities and GST legislation excludes all 'securities' as per The Securities Contracts (Regulation) Act, 1956 possibility of litigation cannot be ruled out. While there are no specific disclosure requirements under ICDS VIII, taxpayer may conservatively wish to disclose in Form 3CD if inventory has been valued 'individual scrip wise' and reasons thereof. However, securities held by scheduled banks or public financial institutions shall be classified, recognised and measured in accordance with the RBI guidelines and not impacted by the provisions of the ICDS VI to that extent.

One may note that classification of security as capital asset or inventory is not governed by ICDS VIII and continues to be governed by the existing tax treatment pre-ICDS.

ICDS IX on borrowing cost

AS-16 on borrowing costs regards a particular asset as 'qualifying asset' if it ordinarily takes more than 12 months to get ready for its intended use or sale, unless other shorter or longer period is justified on the basis of facts and circumstances of the case. Under AS-16, amount of borrowing cost eligible for capitalisation is determined by applying a capitalisation rate to the expenditure on that asset wherein capitalisation rate is the weighted average of the borrowings costs on general borrowings outstanding during that period.

There is no such criteria of 12 months in the definition of qualifying asset under ICDS IX except for inventories. Revised ICDS IX inserted an Explanation to para 6 which provides that for the purposes of capitalisation of general borrowing cost, a qualifying asset is an asset that necessarily requires a period of 12 months or more for its acquisition, construction or production. However, benefit of 12 months criteria is not available for specific borrowing cost, except in case of inventories. As regards inventory, one may argue that proviso to s. 36(1)(iii) and thereby ICDS IX do not apply to stock-in-trade since inventory cannot be put to use. By and large, capitalisation requirement under ICDS IX is reconciled to AS-16 except a few deviations. While 12 months condition is available under ICDS IX for inventory and qualifying assets acquired out of general borrowings akin to AS-16, capitalisation parameters are not the same since as per AS-16, capitalisation is by way of scientific formula whereas under ICDS IX, it is on the basis of normative formula which is as under:

$$\frac{A}{C} \text{ X } \text{B i.e. borrowing cost incurred X } \frac{\text{Average cost of qualifying asset}}{\text{Average amount of total assets}}$$

where it excludes specific borrowing cost, qualifying asset and total assets to the extent they are directly funded out of specific borrowing.

While applying the above normative formula on asset-by-asset basis (refer FAQ 22 of the Circular), interest capitalised in books to the cost of qualifying asset as per AS-16 should be excluded while determining the cost of qualifying asset (numerator) to avoid cascading impact of capitalisation of interest on interest. However, total assets in denominator of normative formula shall be taken at their book values since the reference is to the 'amounts' as appearing in the balance sheet. Further, such total assets should be taken on gross basis without reducing current liabilities.

Component of borrowing cost may also differ under AS-16 and ICDS IX on account of specific tax provisions. FAQ 20 of the Circular states that only those borrowing costs which are otherwise allowable as deduction are to be capitalised and not borrowing costs disallowed u/ss. 43B, 40(a)(ia) etc. In relation thereto, if interest is subsequently allowable on payment basis or after TDS compliance, can such interest be claimed as revenue expenditure or needs to be capitalised for the purposes of ICDS IX. However, technically taxpayer may argue that interest covered by proviso to s. 36(1)(iii) is not allowable as 'deduction' and hence, does not enter within the scope of computation to get disallowed by disallowance provisions. The disallowance provisions apply to expenditure which, but for such provisions, are allowable as deduction.

Accounting policy adopted for borrowing cost and the amount of borrowing cost capitalised during the previous needs to be disclosed by the taxpayer in its Form 3CD. For disclosure purposes, disclosure of the aggregate amount of borrowing cost capitalised under ICDS IX should suffice. However, taxpayers will need to maintain asset-wise memorandum accounts for future reference since cost of depreciable assets will be determined after considering impact of capitalisation under ICDS IX. Explanation 8 to

s. 43(1) provides that borrowing costs incurred for acquisition of an asset, which are relatable to periods after the asset is put to use, cannot be capitalised as part of the cost of the asset.

ICDS X on provisions, contingent liabilities and contingent assets

AS-29 provides that 'provision' for a liability should be recognised when it is 'probable' that it shall crystallise and 'contingent asset' should be recognised when there is 'virtual certainty' of receipt. Thus, there is a different criteria for recognition of expense and income under AS-29 based on well settled accounting principle of 'prudence'. However, ICDS does not recognise the principle of prudence. It seeks to bring parity between the two by providing that both provision and contingent asset shall be recognised when there is 'reasonable certainty'. The term 'reasonable certainty', though not defined, has been used in other AS/ ICDS also such as AS-9, ICDS III, ICDS IV etc.

There could be some debate whether *qua* 'provision' for liability, the threshold of 'reasonably certain' is a higher, lower or same threshold as 'probable'. It is arguable that the two are not materially different and hence, provision which was hitherto recognised for tax purposes as per the ratio of SC in *Rotork Controls India Pvt Ltd. vs. CIT (2009) 314 ITR 62 (SC)* and approved by the statutory auditor under AS-29 should be permissible under ICDS X as well. But, it is clear that qua 'contingent asset', the threshold of 'reasonably certain' is lower than 'virtually certain' resulting in accelerated recognition of income before its recognition in books of account.

The transitional provision provides that all provisions and contingent assets shall be recognised in FY 2016-17 in accordance with ICDS X after taking into account the amount recognised, if any, in any previous year prior to FY 2016-17. Taxpayer would thus be required to review all past events to see whether any provision or contingent asset is to be recognised or derecognised in accordance with the provisions of this ICDS. FAQ 23 of the Circular explains the transitional provision with the help of an example on recognition of 'provision'. As a corollary, the Circular implies that all contingent assets which had crossed 'reasonably certain' criterion in past but were not recognised in books as per AS-29 should be cumulatively recognised in FY 2016-17. This can lead to significant adverse impact for taxpayers who have filed claims against the customers and are at various stages of negotiation/arbitration/dispute. Taxpayers can contend that the Circular is not binding on them since there can be no taxation of illusory or hypothetical income over which taxpayer has no enforceable right. Nevertheless, since litigation is more likely to arise, taxpayers will need to gather factual evidences of irrecoverability of each such claim and keep on record of the AO while defending its own case and also disclose the fact of such non-recognition of contingent asset in its Form 3CD by providing rationale thereof.

Conclusion

Since ICDS is, to a large extent, based on AS, it shall become imperative for taxpayers to streamline their books of account with proper disclosure of accounting policies to ensure smooth transition to ICDS. Care should be taken for making appropriate adjustments under ICDS as compared to the books of account. In case taxpayers wish to take a detour from ICDS by adopting correct legal position as per past jurisprudence on accrual of income and real income theory (say, for example, recognition of interest income on due basis), proper full and true disclosures need to be made by taxpayers in Tax Audit Report in Form 3CD. Taxpayers may appropriately need to factor in the cost-benefit-risk analysis considering time and cost involved in litigation, if it arises, or may simply follow ICDS provisions.

CA Ketan Vajani

Issues in Tax Audit – Part 1 – Clauses 1 to 20

The significance of Audit u/s. 44AB of the Income-tax Act, 1961, popularly known as "Tax Audit", cannot be undermined in any manner from the angle of any of the stakeholders. The government looks at it as an assurance of the compliances made by the tax payer so as to restrict the number of scrutiny assessments. The tax payers also do get an assurance that the accounts prepared by their accounts team are accurate and that there is no known tax non -compliance which will attract sever consequences in the future. For chartered accountants, this has been one of the wonderful professional opportunities. Due to mass coverage of a large number of assesses, it is easier for even a young professional to get some work in this area and give initial impetus to his practice. Considering the usefulness of this subject for all the concerned, the journal committee has aptly thought of having this special story in the busy season of tax audit. I am sure that the articles in this issue will add to the treasure of the knowledge of the readers and they will find this issue as a great reference material during this season.

As mentioned above, for a professional, Tax Audit is certainly an opportunity but we dare forget that this opportunity comes with a challenge which lies within. There are many challenges in conducting the Tax Audit in an effective manner starting right from having a proper team, timely compliance, technological issues, and above all constantly developing law of Taxation.

This article seeks to deal with some of the issues that have emerged in the area of development of law over the period of past few years and which keep on bothering the tax professionals and auditors time and again. The mandate of the article is to deal with the issues arising out of clauses 1 to 20 of the Form No. 3CD. Since the fine tuning and disclosure of ICDS is dealt with in a separate article, I may just touch upon this topic if and when required without venturing into deeper waters as far as the ICDS is concerned.

Issues arising out of Clauses 1 to 20 of Form No. 3CD

There can be numerous issues on each of the clauses. The attempt here is to address some of the issues that arise frequently and are having large scale utility. There can certainly be many more issues then the ones discussed hereunder. Let us now deal with some of the issues that are commonly experienced in conducting the Tax Audits arising from clauses 1 to 20 of Form No. 3CD.

Clause – 4 : The liability of the assessee to pay Indirect Taxes and Reporting in respect thereof

Clause – 4 of Form 3CD requires the auditor to report as to whether the assessee is liable to pay indirect taxes as specified in the clause and if yes, to furnish the registration numbers / identification numbers allotted under the respective statute.

Here the first challenge for the auditor is the ability to figure out as to whether the assessee is liable to pay the indirect taxes. The auditor needs to understand the business modalities of the assessee properly so as to have an idea about the liability to pay the indirect taxes. There can be some difficulties in this area considering the fact that the indirect tax laws are quite complex and at times it is very difficult for the auditor to be certain about the applicability or otherwise of a particular indirect tax. Since the tax auditor himself may not be an expert in the field of indirect taxes, he may not be able to comment on the liability of the assessee to pay indirect taxes. Here the auditor should ideally take the help of experts in the area of Indirect Tax and get a certificate from them as to which are the taxes applicable to the assessee. The auditor can also refer to the earlier year's reports and find out if there is any change in the nature of business as compared to the earlier year.

Clause 9 : Change in constitution of the Firm

Clause 9 of Form 3CD requires the auditor to give information about the partners and their profit sharing ratio and also about the change in constitution of the firm. Sub-clause (b) of the clause requires the auditor to furnish the particulars in cases where there is change in the partners or members or in their profit sharing ratio since the last date of the preceding year. Here a common question which is raised many times is : whether the reporting is required where there is a change in the appropriation of remuneration between the partners or where the rate of interest is reduced or increased as compared to the earlier year though it is certainly within the limits prescribed u/s. 40(b) of the Act ? I personally feel that in such situations there is no reporting which is required under clause 9(b). The clause is relevant only for reporting the change in the profit sharing ratio and not for changes in the remuneration or interest of the partners. At the same time, I feel that in a case where an erstwhile minor partner is continuing as a partner on attainment of majority, the details need to be given in clause 9(b). This is for the reason that a major partner will also be sharing the losses which is not a case for a minor admitted to be benefit of the partnership.

Clause 10 : Change in the Nature of Business

Clause 10 (b) of Form 3CD seeks the particulars of the change in the nature of business. Here one needs to note that the reporting is required only if there is change in the nature of business and not the modalities of doing the business. Backward and /or forward integration of business may be reported if the same is relevant considering the overall business of the assessee. If however the effect of such integration is insignificant, it may not be required to be reported. Discontinuation of particular segment of business needs to be reported if the discontinuation is of a permanent nature. A temporary suspension of a particular segment of business however, need not be reported.

Clause 11(b) : List of Books of Account maintained and the addresses at which the books of account are kept

Particulars are to be given about the books of account maintained by the assessee and the address at which such books of account are kept. If the books are kept at more than one place, it is necessary to give all the addresses at which the books of account are kept. An interesting issue comes up where the books of account are maintained in a SAP / ERP software. Here the books of account are not physically kept at any particular location but they are stored in the cloud. In such a situation, it seems that the address shall be the one where the printouts of such books of account are normally kept and there should be a mention to the effect that the books of account are actually maintained on clouds and the printouts are maintained at a particular address. [Reference is invited to clause (12A) of section 2, which defines "books or books of account".]

After dealing with some of the preliminary issues, it is now time to venture into more technical issues that arise from various clauses of Form 3CD.

Clause 12 : Reporting for Profits and Gains under Presumptive Taxation under specified sections

Clause 12 of Form 3CD requires the tax auditor to report as to whether the profit and loss account includes any profits and gains assessable on presumptive basis under the sections specified therein. If the profits under these sections are included, the auditor is required to indicate the amount of such profits included.

Amendment made to Section 44AD by Finance Act, 2016

Finance Act, 2016 has made substantial amendments to section 44AD of the Income-tax Act and the amendments are applicable w.e.f. A.Y. 2017-18. This being the first year after the amendment, it is thought appropriate to list down the points on which the position has changed due to the amendment. The amendment mainly alters the following position under section 44AD :

- Limit of Turnover for eligible business is increased to ₹ 2 Crores from earlier ₹ 1 Crore
- No deduction for Interest and Remuneration to Partners will be allowed from the profit computed under section 44AD. This will result in tremendous hardship in the cases of partnership firms. In fact due to this amendment, more number of partnership firms will now need to undergo audit u/s. 44AB r.w.s. 44AD.
- Sub-section (4) of section 44AD provides that once an assessee opts for presumptive taxation scheme, he will have to offer the income under presumptive scheme for subsequent five years. In case he chooses not to offer income under presumptive scheme for any of the five years, he will be deprived from opting for the scheme for five years subsequent to the year in which he opts out of the presumptive scheme. For Example : The assessee opts for presumptive scheme for A.Y. 2017-18, then he has to continue opting for the scheme for A.Y. 2018-19 to A.Y. 2022-23. In case if he opts out of the scheme in any of these years, say in A.Y. 2020-21, then he will not be allowed to opt for the scheme for subsequent five years i.e. for A.Y. 2021-22 to 2025-26. This is also likely to create lots of difficulties.

Amendment made by Finance Act 2017 with retrospective effect from A.Y. 2017-18

Finance Act, 2017 has inserted a proviso to sub section (1) of section 44AD. The proviso is inserted with effect from 1-4-17 and therefore will be applicable for A.Y. 2017-18 also. As per the proviso, the profit is to be computed at 6% instead of 8% of the turnover in respect of the amount of total turnover or gross receipts which is received by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account during the previous year or before the due date specified in sub section (1) of section 139 in respect of the previous year.

As such, the benefit of concessional rate of 6% will be available provided (a) the amount is realized by account payee cheque / draft / ECS and (b) the amount is realized latest by the due date u/s. 139(1) of the Act. Therefore, it will now be necessary to maintain break-up of the turnover which will have deemed profit at 8% and at 6%.

The amendments made by Finance Act, 2016 and Finance Act, 2017 have in fact made the section 44AD as a complex piece of legislation and there are various difficulties that are arising on account of these provisions. In fact, looking at the amendments, one really wonders whether such provisions are at all encouraging for any assessee to opt for the presumptive taxation scheme. The presumptive taxation scheme shall be simple and shall be such that even layman can understand and implement the scheme without much of difficulty. This basic theme of presumptive taxation scheme is completely lost as far as section 44AD is concerned. It seems that many assessees will in fact get discouraged to opt for the scheme and therefore the number of audit assignments is going to increase notwithstanding the increase in the amount of turnover qualifying for the scheme.

Some Issues that arise for the purpose of Tax Audit u/s. 44AD r.w.s. 44AB

Consider a case where the assessee is engaged in more than one business and one of the businesses is the eligible business. As per the scheme of the Act the tax-audit will be necessary where the turnover in respect of the non-eligible business is exceeding two crore rupees. However while conducting the audit, the auditor will need to certify the turnover and the profit of the eligible business qualifying for section 44AD. A couple of interesting issues come up in the process.

Verification of Break-up of Turnover

As mentioned above, due to the amendment made by Finance Act, 2017, part of the turnover will have the income element of 6% and the balance part of the turnover [i.e. either received in cash or not realized within the due date u/s. 139(1)] will have profit element @ 8% of the turnover. The auditor will need to verify the break-up of the same so as to confirm the amount of profit computed by the assessee.

Common Expenses

Another issue which can come up is about the common expenses incurred by the assessee for the purpose of the eligible business and non eligible business. As per the scheme of the Act, all the expenses in respect of the eligible business are deemed to have been allowed while computing the profit @ 8% or 6% as the case may be. In the situation, can one claim that the common expenses which are not having direct connection with either of the two businesses can be claimed as a deduction against the profits of the non-eligible business. Apparently it seems that there is no reason for not allowing such deduction against the profits of the non-eligible business. There is no express provision under the Act which denies such deduction. In absence of any provisions akin to section 14A, which provides for disallowance of expenses incurred to earn exempt income, it seems that there should not be any problem in claiming the deduction of common expenses and there may actually not be any need to make any proportionate disallowance in this regards. For this purpose useful support can be drawn from the decision of the Supreme Court in the cases of *CIT vs. Indian Bank Ltd 56 ITR 77 (SC)* and *Rajasthan State Warehousing Corporation vs. CIT 242 ITR 450 (SC).*

Clause 13 : Method of Accounting and Change in Method of Accounting

Clause 13 (a) to 13(c) of Form 3CD requires reporting about method of accounting and change in the method of accounting. It is therefore relevant to revisit some of the fundamental principles in connection with the above topic.

Section 145(1) of the Act permits an assessee to maintain the books of account either following the cash system of accounting or mercantile system of accounting. The method of accounting shall be regularly employed by the assessee on a consistent basis. The hybrid system of accounting is not permissible to be adopted for quite many years now. Further the method of accounting has to be consistent and shall not be changed unless there are valid reasons for the change. The change in method of accounting does not require any prior approval from the tax authorities [Ref : *Snow White Food Products Co. Ltd. vs. CIT 141 ITR 847 (Cal.)]*. However, at the same time the change in the method of accounting shall be such that the new method adopted shall be an accepted method of accounting under the commercial accounting principles. The purpose of change in the method of accounting shall be genuine and it is not permissible to change the method of accounting only for the purpose of avoiding the taxes.

A change in the method of accounting may result in reduction of profits for a particular year. However if the change is a bonafide change and the newly adopted method of accounting is to be adopted consistently thereafter, the same cannot be objected by the revenue even if the change is likely to result in reduction of tax liability. Useful reference for this proposition can be made to the decisions of the High Courts in the cases of C*IT vs. Carborandum Universal Ltd. 149 ITR 759 (Mad) ; Melmould Corporation vs. CIT 202 ITR 789 (Bom.); CIT vs. Atul Products Ltd. 255 ITR 85 (Guj.).*

Change in the method of valuation of closing stock

In the case of CIT Vs. Carborandum Universal Ltd. 149 ITR 759 (Mad) the assessee was following total cost method for valuation of stock. For A.Y. 1971-72, the assessee changed the method of valuation of closing stock to direct cost method. The Madras High Court held that since valuation of stock at direct cost method is one of the recognized method of valuations under commercial accounting principles and since the method is intended to be followed consistently in the subsequent years, the change in the method of accounting is permissible. The department also contended that if the method of valuation of closing stock is changed to direct cost method, the same method shall also be adopted for valuation of opening stock and therefore corresponding adjustment shall be made to the value of the opening stock. The Madras High Court held that there was no need to change the method of valuation of opening stock for the reason that if such change is made in the current year, corresponding adjustment will also be required to the closing stock value of the earlier financial year. The Madras High Court also observed that if such exercise is done, it will be impermissible for an assessee to change the method of accounting at any time whatsoever. Accordingly it was held that when the method of valuation of closing stock is changed for valid reasons, there is no requirement for changing the method of valuation of the opening stock also. Even if the change in the method of valuation results in reduction of tax liability, the effect thereof will be nullified over the period of years and there will not be any revenue loss on account of such change. Similar view has also been adopted by the Bombay High Court in the case of *Melmould Corporation vs. CIT 202 ITR 789 (Bom.).*

Different method of accounting for different sources under the same head of income

There is hardly any doubt about the proposition that an assessee can follow different methods of accounting for different heads of Income viz. Profits and gains of business or profession and Income from other sources – Refer : *J. K. Bankers vs. CIT 94 ITR 107 (All.).*

However an interesting issue arises in a case where the assessee is following different methods of accounting for different source of income although taxable under the same head of income. Say for example, an assessee is engaged in some business and is also engaged in a profession. For the professional income, the assessee would like to follow cash system of accounting whereas for the business income, he would normally follow mercantile system of accounting. Whether this is permissible or not? Whether following different methods for different sources amounts to adopting hybrid system of accounting ?

Here it is pertinent to note that each source of income is a separate and distinct source of income and there is no express bar under the provisions of the Act to adopt different method of accounting for different sources under the same head of income. Section 145(1) of the Act permits an assessee to either adopt the cash system of accounting or mercantile system of accounting. Both the methods are permissible and there is no provision that one of the methods followed for a particular source of income has to be followed for all the sources under the same head of income. This issue has been recently addressed by the decision of the Mumbai Tribunal in the case of *Vishwanath Acharaya vs. ACIT 157 ITD 1032 (Mum.).* The Tribunal has held that the assessee is entitled to follow different methods of accounting for different sources of income under the same head of income. The tribunal has appreciated the fact that even in a case where the cash system of accounting is followed by the assessee, the revenue will be recognized in the subsequent year and it will eventually be tax neutral. The tribunal also held that in a case where the assessee follows different method of accounting for different sources of income, it cannot be said that the method of accounting adopted by the assessee is hybrid method of accounting.

Similar is the case where the assessee follows project completion method of account for one of its projects and percentage completion method of accounting for another project. Here also since there is no bar under the Act, this is held to be be permissible. – Refer : *CIT vs. Umang Hiralal Thakkar (2014) 42 taxmann.com 194 (Guj).* However this proposition may now need to be realigned with the introduction of Income Computation and Disclosure Standards and the impact of the same on revenue recognition.

Sub-clauses inserted in Clause 13 on account of ICDS

With effect from A.Y. 2017-18, sub-clauses (d) to (f) have been inserted in Clause 13 of the Form 3CD. These sub-clauses are inserted with the purpose of reporting on the ICDS which have become applicable with effect from A.Y. 2017-18. Since there is a separate article dealing with impact of ICDS, we will not deal with the same in this article. Many issues are likely to arise on account of implementation of ICDS but I am sure the same will be dealt with in detail in the special article dedicated to this topic.

Let us however take a note that clause 13(e) of Form 3CD requires to give the details about increase or decrease in profit on account of all the ten ICDS. Similarly clause 13(f) requires to give the disclosures in respect of the ICDS specified therein. We are aware that all these ICDS have specified disclosure requirements. These disclosures shall be made in clause 13(f) of the Form 3CD. Needless to mention that because of the insertion of these clauses in Form 3CD, the amount of increase or decrease in the profits and also the disclosure under the relevant ICDS is certified by the chartered accountant as true and correct. Accordingly the tax-auditor needs to adopt the regular auditing techniques and obtain reasonable assurance about the correctness of the same.

Clause 14 : Method of valuation of closing stock and Deviation from section 145A

Clause 14(a) of Form 3CD requires to give the details as regards the method of valuation of the closing stock. Clause 14(b) requires the details about effect of deviation from method of valuation prescribed u/s. 145A.

The assessee is allowed to adopt a method of valuation of closing stock in consonance with the principles of commercial accounting. As per Accounting Standard-2 [AS-2] issued by the Institute of Chartered Accountants of India, the valuation of the stock is to be done on the basis of cost or net realizable value, whichever is lower. Further AS -2 provides that the cost shall be adopted either on FIFO or weighted average basis. The cost of the items which are not interchangeable or goods produced for specific projects are to be measured on specific identification of their individual costs. The tax auditor will also have to bear in mind the implications of ICDS-II on "Valuation of Inventories".

As per the settled position, the method of valuation of stock is adopted by the assessee is to be consistently followed unless there are compelling and bona-fide reasons for change in the method of valuation of stock. At the same time, it has been held by the Supreme Court in the case of *CIT vs. British Paints India Ltd. 188 ITR 44 (SC)*, that an incorrect method of valuation cannot be allowed to be followed even if the same has been followed by the assessee in earlier years.

Impact of Section 145A where the valuation is on net realizable value

Section 145A of the Act provides that the valuation of purchase, sales and inventory shall be in accordance with the method of accounting regularly employed by the assessee and the same shall be further adjusted to include the amount of any tax, duty, cess or fee paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Whether net realizable value to be enhanced with tax element for valuation

An issue comes up in a case where the net realizable value of the particular goods is lesser then the cost. The issue is whether in such a situation also the element of taxes are to be further added in such net realizable value and the value of the inventory is to be made inclusive of tax ? Say for example : The cost of the inventory without taxes is ₹ 100 and the tax on the same is ₹ 10/-. However, the net realizable value of the inventory on the date of valuation has been reduced to ₹ 85/-. In such a situation whether the valuation shall be made at ₹ 85/- or it shall be made at ₹ 95/- (i.e. ₹ 85/- + ₹ 10/-).

It seems that the correct position is that in such a situation, the valuation will be made at ₹ 85/-. The element of tax i.e. ₹ 10/- is to be included for the purpose of deciding the cost of the particular item and not for the purpose of determining the net realizable value. Considering the scheme of section 145A, it appears that the same operates in the field of determination of cost and can certainly not work in the field of deciding the net realizable value which is determined by market factors. Therefore, in the given example, the cost will be ₹ 110 (₹ 100 + ₹ 10) and the net realizable value being ₹ 85/- the valuation shall be made at ₹ 85/- without further loading the element of tax on the same.

MODVAT Credit in a case where the assessee follows exclusive method of accounting

Though section 145A of the Act provides that the valuation of purchases, sales and inventory has to be made inclusive of the taxes, the commercial accounting principles permits an assessee to follow the exclusive method of accounting for these items, meaning thereby that the assessee is permitted to account for these items without considering the element of tax on the said items. Whether one follows inclusive method of accounting or exclusive method of accounting, the resultant profit will be the same and there will not be any impact on the profits as long as the concern is a going concern. Accordingly the exclusive method of accounting is permissible and there is no impact of section 145A in a going concern.

An interesting issue came up before the Hon. Bombay High Court in the case of *CIT vs. Indo Nippon Chemical Co. Ltd. 245 ITR 384 (Bom).* The assessee was following exclusive method of accounting and had accordingly not included the element of taxes in the valuation of the inventories. The department contended that since the excise duty paid by the assessee on the purchase of raw materials gives rise to an irreversible Modvat credit, the unutilized Modvat credit on the raw material lying in stock at the end of the year shall be treated as income of the assessee. The Bombay High Court held that though the Modvat credit is irreversible in nature, the same is an outgoing for the assessee and cannot result in the income of the assessee. The High Court agreed with the proposition that in a case where the purchases are accounted on net method, the valuation of closing stock cannot be made on gross method and that there cannot be any understatement of profits where the assessee is following net method of accounting. Accordingly the High Court dismissed the appeal of the department. This view of the Bombay High Court was also upheld by the Hon. Supreme Court in *CIT vs. Indo Nippon Chemical Co. Ltd. 261 ITR 275(SC).* This has also been again followed by the Supreme Court in the case of *CIT vs. Shree Ram Honda Power Equipment Ltd. 352 ITR 481 (SC).*

However, the assessment year concerned in the case of Indo Nippon was A.Y. 1989-90 and in the case of Shree Ram Honda Power it was A.Y. 1995-96. Section 145A was inserted in the Income-tax Act w.e.f. 1-4-1999 and accordingly sometimes a doubt is expressed by professionals as to whether the above decisions will still be applicable after insertion of section 145A in the statute. It is however to be noted that even after insertion of section 145A, nothing much has changed and the valuation of closing stock can still be made on net method for the purpose of accounting. The compliance with section 145A of the Act will be taken care of by preparing a reconciliation statement and the reconciliation statement will reflect a NIL impact on the adjustment to be made on simple arithmetic. Accordingly the Modvat credit on the unutilized stock of raw materials is neither to be considered as a part of the stock nor to be separately included as income of the assessee. In fact very recently the Hon. Bombay High Court in the case of *CIT vs. M/s. Diamond Dye Chem Ltd. (ITA No. 146 of 2015 – Order dated 7th July, 2017* – itatonline.org) has reaffirmed the above position where the assessment year was 2008-09. Accordingly it seems that the above issue is a settled position of law now.

Clause 15 : Particulars of Capital Asset converted into stock in trade

Clause 15 of Form 3CD requires to give the details in relation to capital assets converted into stock in trade. Sub-clause (c) is about the cost of acquisition. Here it is to be noted that the cost of acquisition need not always mean the actual cost of acquisition to the assessee. In cases where the asset is acquired by some other modes as provided in section 49 or section 55(2)(b) of the Act, the cost of acquisition as provided in the relevant section shall be mentioned in this column. For example, where the asset is acquired prior to 1-4-1981, the FMV as on 1-4-1981 can be mentioned or where the asset is acquired by way of gift or inheritance the cost to the previous owner will be the cost for the assessee.

Clause 16 : Amounts not credited to Profit and Loss Account

Clause 16 requires the details about the amounts not credited to the profit and loss account and being covered by sub-clauses (a) to (e) of the said clause.

Sub-clause (a) talks about the items falling within the scope of section 28. The auditor is expected to list down the items which are though covered within the scope of section 28 of the Act, they are not credited to profit and loss account. This can be done by the auditor on the basis of examination of various documents and facts that comes to his knowledge during the course of the audit. A perfect understanding of the modalities of the business will be of great help in finding out such items which are in a way non-cash items. Some common examples can be free or concessional holiday trip to partners / directors offered by the suppliers on achieving some particular business targets, free samples given by suppliers, gifts received from suppliers, barter transactions with the suppliers etc.

Sub-clause (c) mentions about escalation claims accepted during the year. Here an issue can come up as to whether the details need to be given in a case where the assessee is following the cash system of accounting. As per the principles of cash system of accounting the escalation claim, though accepted, it will not take the colour of income till the time it is actually received. One needs to always bear in mind that all the information in Form 3CD has to be provided keeping in mind the basic method of accounting followed by the assessee and in such a situation the reporting is not required.

Sub clause (d) requires details about any other item of income. Here also the auditor's overall examination of the documents and understanding of the business will enable him to find out if any such items are there which are income but not credited to profit and loss account. Some examples can be where some of the incomes are directly credited to the capital account of the proprietor / partners. The auditor will need to report such items irrespective of the fact that whether such items are exempt items, say for example dividend, or non-exempt income.

Sub clause (e) requires the details about capital receipt, if any. There is some conceptual error in this clause and in my humble view it is not appropriate to call for information for the receipts which are capital in nature. The purpose of tax-audit is to determine correct figure of taxable income of the assessee and capital receipts cannot take the colour of income under normal circumstances. As such, the above clause itself is unnecessary. However, since the clause is specifically placed in Form 3CD, the auditor needs to provide for the information sought. There can be various such capital receipts like, LIC maturities, share capital, gift etc. It is desirable for the auditor to mention these items and also put appropriate note that the items are capital receipt and does not have the element of income. It will be advisable to give detailed note in respect of each of these items so as to avoid any unnecessary additions in the hands of the assessee by mechanically referring to the figures put in this clause.

Clause 17 : Details about Section 43CA or Section 50C

Clause 17 of Form 3CD requires the details in respect of the land or building or both transferred during the year for a consideration less than value adopted or assessed or assessable by authority of state government referred to in section 43CA or 50C.

Whether this clause is applicable to transactions in respect of Capital Assets ?

The first and foremost question which comes up is whether the information in this clause is required to be given for transactions in respect of capital assets or not? Section 44AB falls in chapter IV-D of the Act dealing with Profits and Gains of Business or Profession. Accordingly it does not seem logical to include reporting in respect of capital gains transactions while conducting the Tax Audit u/s. 44AB. The confusion arises due to mentioning of section 50C in clause – 17 of the Form. However, I personally feel that no reporting is required for transactions in capital gains under this clause. This is for the reason that the scope of audit under section 44AB cannot be extended beyond the chapter of profits and gains of business or profession.

However, contra to this, there is another argument that Form 3CD has few such clauses which extend the scope of Tax Audit beyond the chapter of profits and gains of business or profession. For example clause 28 and 29 of the Form deals with section 56(2)(viia) and 56(2)(viib) respectively, which is under the head of Income from Other Sources.

Though this argument is a valid argument, from the language of clause 17, it does not seem that the information in respect of capital gains transactions is required. Clause 17 requires the details in respect of the land or building or both transferred during the year for a consideration less than value adopted or assessed or assessable by authority of state government referred to in section 43CA or 50C. Thus it seems that the clause talks about the authority of the state government referred to in section 50C and not the transactions referred to in section 50C. We have got catena of decisions which lay down that the provisions of section 50C do not apply to stock in trade and that was the precise reason for the introduction of section 43CA. Applying the rationale of these decisions, one can surely contend that the information for transactions resulting into capital gains need not be reported under clause 17. The information is required for only the transactions covered by section 43CA. Reference is invited to the decision of Bombay High Court in the case of Ghai Construction vs State Of Maharashtra And Ors. dated 30/04/2007 where it is held that the requirement of compulsory audit is only in respect of the business carried on by the person and not in respect of his income from other sources.

Issues arising on account of Section 43CA

Section 43CA of the Act provides for replacing the value adopted or assessed or assessable for stamp duty purpose instead of the actual consideration in respect of transfer of an asset (other than a capital asset) in a case where the consideration is less than the stamp duty value. The provisions have been bodily lifted from section 50C which operate in the same area in relation to a capital asset. There are several issues which emerge on account of section 43CA. The issues arise right from the terminology used in the section as to whether the terms used in section 43CA like "transfer of an asset", "consideration received" etc., are appropriate under the head of profits and gains of business or profession to constitutional validity of such provisions and also practical difficulties which are bound to arise due to such harsh provisions. However, since we are concerned with the issues arising in conducting the Tax Audit, we will restrict our discussion broadly to the extent of tax audit. We for the time being assume that all other issues are not relevant and the provisions of section 43CA has to be read with due modification of some of the terms as may be required so as to effectively advance the purpose of the enactment.

Whether section 43CA applies in the case of percentage completion method ?

The first question which comes here is whether the provisions of section 43CA apply in a case where the assessee is following percentage completion method of accounting. If yes, then how to compute the amount of sales (as duly replaced by stamp duty valuation) for each year of construction activities?

One extreme view can be that in a case where the assessee is following percentage completion method of accounting, the provisions of section 43CA cannot be applied for the reason that the stamp duty value adopted in one year need not be the same in the second year and so on. Also on the language of section 43CA, there cannot be any applicability in case of percentage completion method. However, such an extreme view will lead to the provisions of section 43CA being redundant and therefore it appears that the courts are not likely to agree with such a view. Therefore, a question comes up as to how to apply the stamp duty valuation over the number of years over which the revenues are accounted in the books of the assessee?

It seems that the better view is that the stamp duty valuation is to be applied once the property in the particular unit is transferred by way of registration and conveyance and the said stamp duty value will be treated as the sale consideration. The sale consideration for the entire project will be reworked applying stamp duty value for each unit and the percentage completion will be applied after considering the stamp duty valuation instead of actual sale consideration.

Whether Section 43CA will have to be given effect while computing the Deduction u/s. 80-IBA ?

Section 80-IBA has been inserted into the statute w.e.f. 1-4-2017 i.e. A.Y. 2017-18. The section is akin to earlier section 80-IB(10). The section provides for deduction of 100% of the profits and gains derived from the business of developing and building housing projects subject to certain conditions. A question comes up as to whether the amount of deduction allowed under this section will be computed after giving effect to the provisions of section 43CA or it will be computed based on the accounting profit.

The answer seems to be simple and logical that for computing the deduction amount also the provisions of section 43CA will have to be given effect to and the profits and gains will be computed after considering the stamp duty value as the sale proceeds in a case where the actual transaction value is lesser than the stamp duty valuation. Section 43CA is part of Chapter – IV D and all the provisions of the chapter will have to be given effect to arrive at the profits and gains of business or profession. Secondly the deeming fiction as provided u/s. 43CA has to be taken to its logical conclusion so as to avoid any absurd situation which would otherwise arise.

Whether payment by journal entries will be eligible for the benefit provided by sub-section (3) of section 43CA ?

Sub-section (3) of section 43CA provides that where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer of asset are not the same, the stamp duty valuation as on the date of agreement will be considered as the valuation under section 43CA. Sub-section (4) provides a restriction that such benefit of taking the valuation as on the date of agreement will be available only in a case where the amount of consideration or part thereof has been received by any mode other than cash on or before the date of agreement for transfer of the asset.

It seems that in a case where the builder is having a pre-existing debt by way of a loan or a trading transaction and the consideration for the unit is paid by way of adjustment of such credit in the books of account of the builder, the same will qualify for getting the benefit of valuation as on the date of agreement. This is for the reason that the sub-section (4) talks about any mode other than cash and does not talk about the transaction by bank or electronic system.

Issues arising out of section 50C

Earlier a view has been taken that the transactions in respect of capital assets are not required to be reported in Form No. 3CD. However, if at all an auditor takes a view to the contrary and wishes to report the transactions in respect of capital assets also, then let us understand the issues which emerge out of provisions of section 50C. Further, since the provisions of section 50C and section 43CA are almost similar, the discussion of these issues may also be helpful while reporting in respect of the transactions covered by section 43CA.

Transfer of Land or Building or both

Section 50C provides for replacing the stamp duty valuation in place of full value of consideration for the purpose of computation of capital gains arising on transfer of a capital asset being, land or building or both. It is pertinent to note that the section applies for transfer of land or building or both and not for any "immovable property". Immovable property is a much wider term as compared to land or building and many other types of property can be covered as immovable property though the same may not be either land or building. Accordingly a question comes up whether section 50C will be applicable in a case where the assessee transfers other capital assets like tenancy rights, leasehold rights, TDR / FSI, Development Rights etc.

Section 50C is a deeming fiction and it replaces the value of full value of consideration in section 48 which is the computation provision. Since it is a deeming fiction and it enlarges the scope of taxation by way of import of the deemed value in the computation provision, the Tribunals have consistently held that the same has to be strictly construed. On language of section 50C, it is clear that it applies only in relation to transfer of a capital asset being land or building or both. Therefore the same cannot be applied to other species of immovable property.

The Mumbai Tribunal in the case of *Smt. Kishori Sharad Gaitonde vs. ITO – ITA No. 1561/M/09 Dated 27-11-09* – itatonline.org held that section 50C cannot be applied in case of transfer of tenancy rights. Similarly it has also been held by Mumbai Tribunal in the case of *Atul G. Puranik vs. ITO 132 ITD 499 (Mum)* that the section does not apply in case of transfer of leasehold rights. In fact this decision of the Tribunal gets impliedly approved by the Bombay High Court in the recent decision of Greenfield Hotels & Estates P. Ltd. – ITA No. 735 / 2014 (Bom.) Dt. 24-10-16 – itatonline.org. The High Court in this case held that since the department has not filed any appeal to High Court in the case of Atul Puranik, the position is accepted by the department and therefore it is not permissible to file appeal to High Court for the accepted position. Similar view has been taken by the Tribunals in the cases of *Farid Gulmohamed vs. ITO ITA No. 5136/Mum-2014 Dt. 16-3-2016 itatonline.org ; ITO vs. Hariom Gupta 45 ITR (Trib.) 137 (Luck.).* As regards the transfer of TDR / FSI, the Mumbai Tribunal in the case of *ITO vs. Prem Ratan Gupta 31 CCH 384 (Mum.)* (ITA No. 5803/Mum/2009) has again held that section 50C refers to land and building and not to immovable property as a whole. Accordingly, value of TDR could not be subject matter of Section 50C.

However on the peculiar facts of the particular case the Mumbai Tribunal in the case of *Chiranjeev Lal Khanna vs. ITO 132 ITD 474 (Mum)* has held that transfer of development rights is covered by section 50C of the Act. The assessee in this case was the sole owner of a building and the surrounding land. The assessee entered into a development agreement with a developer and transferred the development right to the developer. As per the terms of the development agreement, the developer was entitled to sell 50% of the constructed area and the balance 50% was to be given to the assessee. Considering various clauses of the development agreement, the Tribunal came to a conclusion that by way of entering into development agreement, the assessee is effectively transferring right in respect of the land to the extent of 50% of his right. The right which was hitherto an absolute right will be reduced to 50% right on account of the development agreement. On this basis the Tribunal concluded that the provisions of section 50C will be applicable in the case of the assessee.

Transfer of shares of a company owning Land or Building

An interesting case came up before the Mumbai Tribunal in the case of *Irfan Abdul Kadar Fazlani* *vs. ACIT 56 SOT 12 (Mum.).* In this case the assessee transferred the shares of a company which was in turn owner of immovable property in the form of land and building. There were no other note-worthy assets or business of the company whose shares were transferred. In a way the company was a conduit holding the immovable property. The transfer of shares of the company virtually amounted to transfer of the land and building. On these facts of the case, the department invoked the provisions of section 50C in the case of the assessee.

Mumbai Tribunal held that since the assessee has transferred the shares of the company and not the land or building, the provisions of section 50C cannot be applied in this case. The Tribunal did not accept the view of the department that the ultimate transfer is of the land and building. Further the Tribunal also noted that the transfer of shares was never subject to levy of stamp duty and accordingly the provisions of section 50C will not be workable. Accordingly the Tribunal held that the provisions of section 50C shall not apply.

This decision of the Tribunal was however given for A.Y. 2007-08 and 2008-09. However, the Finance Act, 2017 has introduced section 50CA in the Act. The section provides that if consideration received on transfer of unquoted shares is less than FMV of such share, to be determined in a manner to be prescribed, such FMV shall be taken as full value of consideration. In accordance with this section, Rule 11UAA has now been inserted w.e.f 1-4-2018 (A.Y. 2018-19) referring to the amended Rule 11UA. As per the amended Rule 11UA, the FMV of the unquoted shares is to be determined by considering the value adopted or assessed or assessable by any state government authority in respect of any immovable property held by the company. As such, w.e.f. A.Y. 2018-19, section 50CA and Rule 11UAA will have the effect of nullifying the ratio of the above decision of the Tribunal.

Whether section 50C is to be applied for transfer of an asset forming part of block of assets

Transfer of an asset, forming part of a depreciable block of asset is governed by the provisions of section 50 of the Income-tax Act. Section 50 lays down a deeming fiction overriding the provisions of section 48 and 49 in a case where an asset forming part of block of assets is transferred. The section provides that in such a case, the full value of consideration is to be reduced from the opening written down value of the block of assets and the balance remaining thereafter will be eligible for depreciation for all the future years. In a case where due to transfer of the asset, the WDV becomes negative or where the block of asset ceases to exist, the difference arising shall be treated as short term capital gains for the year in which the transfer takes place.

As against this, section 50C provides for replacing the stamp duty value as full value of consideration in section 48 for computation of capital gains. A question therefore comes up that in a case where a land or building forming part of block of assets is transferred, whether the actual sale consideration is to be reduced from the WDV or the stamp duty value of the same has to be reduced from the WDV. There was a strong view prevalent that since both section 50 and section 50C are deeming fictions, one deeming fiction, namely section 50C cannot be imported into another deeming fictions i.e. section 50 and therefore in such a situation, the amount to be reduced from the WDV will be the actual sale consideration and not the stamp duty valuation. As such, in such a situation section 50C will not have any implication.

The matter was not free from doubt since there were valid arguments both for and against the above proposition. With a view to resolve the issue, a special bench of the Tribunal was constituted in the case of *ITO vs. United Marine Academy 130 ITD 113 (Mum. SB).* The Special Bench after considering all the arguments, held that though both section 50 and section 50C are deeming fictions, both the deeming fictions are working in different fields, whereas section 50C is a deeming fiction operating in the field of sale consideration, the deeming fiction provided under section 50 works in the field of cost of acquisition of the asset. Accordingly, the Special Bench held that both the deeming fictions can hold waters without contradicting the other deeming fiction and therefore section 50C will have to be given effect to even in a case where the transfer of a land or building forming part of block of assets.

Nominal Difference between Stamp Duty Value and Actual Consideration

On many occasions, it is observed that the difference between the transaction value and the stamp duty value is very nominal say about 10 to 15%. Such minor difference is always possible considering the fact that the stamp duty valuation is ultimately an estimate of the price of the property. Estimation always has the possibility of being subjective and some small variation cannot be ruled out. A question comes up whether section 50C will have to be applied even in a case where the difference is very negligible.

Fortunately there are many tribunal decisions in the recent past which have taken a view that if the difference is in the range of about 10 to 15% then, the actual value of consideration can be adopted and there is no need to adjust the same with reference to the stamp duty valuation. Useful reference can be made to the decisions in the case of *Krishna Enterprises vs. ACIT 181 TTJ 677 (Mum.) ; Rahul construction vs. DCIT 38 DTR 19 (Pune)(Trib.) ; Sitabai Khetan vs. ITO 181 TTJ 549 (Jp.)* for this proposition.

Proviso to section 50C by Finance Act 2016 w.e.f. 1-4-2017

The Finance Act 2016 has inserted two provisos to section 50C of the Act w.e.f. 1-4-17 i.e. A.Y. 2017-18. The first proviso provides that where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer of asset are not the same, the stamp duty valuation as on the date of agreement will be considered as the valuation under section 50C. The second proviso, however, provides for a restriction that such benefit of taking the valuation as on the date of agreement will be available only in a case where the amount of consideration or part thereof has been received by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account on or before the date of the agreement for transfer.

These provisos are new provisos inserted w.e.f. A.Y. 2017-18 and accordingly one must take a note of these provisos. In a situation where there is a considerable gap between the date of agreement and date of registration, the assessee can take some advantage in terms of the lower valuation as on the date of agreement as compared to the valuation on the date of registration of the property.

There is a subtle difference in the language of second proviso of section 50C and that of sub-section (4) of section 43CA, though purpose of both the provisions is similar. Whereas the second proviso insists for receipt of the amount of consideration by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account on or before the date of the agreement for transfer, sub-section (4) of section 43CA permits such relaxation in a case where the consideration is received by any mode other than cash on or before the date of agreement for transfer of the asset.

Though it is not relevant for conducting tax audit for A.Y. 2017-18 or subsequent years, the readers may take a note that the Ahmedabad Bench of the Tribunal in the case of Dharmshibhai Sonani Vs. DCIT 161 ITD 627 (Ahd.) has held that the provisos inserted by the Finance Act 2016 are retrospective in operation.

Clause 18 : Particulars of Depreciation

Clause 18 of Form 3CD requires various particulars in respect of depreciation claim of the assessee. The particulars need to be given about the rate of depreciation, opening WDV, additions /deductions during the year, depreciation allowable and closing WDV in respect of each of the block of assets. Depreciation is a statutory deduction available to the assessee and the same is to be allowed in accordance with the provisions of section 32 of the Income-tax Act. Further, it is already a settled position that depreciation is mandatory even in a case where the assessee is not having sufficient income for the year. Some interesting issues keep on arising on recurring basis as far as depreciation is concerned. The same are discussed hereunder :

Classification of asset and relevant depreciation thereon

Rates of Depreciation provided in Appendix I to Rule 5 of Income-tax Rules, 1962. The Appendix provides for different rates of depreciation for different types of assets and therefore it is very relevant to determine the correct classification of a particular asset. The rate of depreciation on plant and machinery is higher than that for the building. Accordingly the assessee would always prefer that the factory building or a building constructed for a particular purpose is considered as a plant for the purpose of claiming the depreciation and therefore this controversy is surfacing very frequently.

The controversy specially arises in cases where the building is a hotel building or a theatre and used primarily as an apparatus to earn income. The assessee therefore is not completely incorrect in taking a stand that the concerned building is a plant. The controversy is an age old controversy going for past many decades now. The Supreme Court in the case of *CIT vs. Anand Theatres 244 ITR 192 (SC)* took a view that a theatre building cannot be considered as a plant for the purpose of depreciation. The Supreme Court in that decision laid emphasis on the fact that though the word plant has been given an inclusive meaning as per section 43(3), it nowhere includes a building. The Supreme Court further held that 'plant' would not include building even if specially designed, in which hotel business or cinema business is carried on. Building is not an apparatus or adjunct for running such businesses. It is a shelter or home for conduct of such business. Cinema business can be run in a premises adapted for that purpose which may or may not be specially designed. Therefore, even applying the functional test it will not be classified as a plant. The Supreme Court however agreed with the claim of the assessee that the electrical installations and sanitary fittings installed in such a building will qualify as plant.

As against this there are many decisions where a building has been classified as plant due to the special type of the design in which the building is constructed. In *CIT vs. Dhampur Sugar Mills Ltd. 375 ITR 296 (All),* a tubewell in the factory premises, has been held to be a plant. In *CIT vs. Express Resorts & Hotels Ltd. 230 Taxman 424 (Guj),* the assessee was engaged in the business of hotel. The assessee claimed that the electrical installations and sanitary fittings fixed in the hotel are plants for the purpose of claiming the depreciation. The claim of the assessee was accepted by the Hon. Gujarat High Court following the decision of the Supreme Court in *CIT vs. Anand Theatres.* The Chandigarh bench of the ITAT held that a factory building constructed with a specific design for a pharmaceutical company will be eligible for depreciation as plant - *DSM Sinochem Pharmaceuticals India P.Ltd vs. DCIT 176 TTJ 322 (Chd.)(Trib.).*

The apex court in the case of *ACIT vs. Victory Aqua Farm Ltd. 379 ITR 335 (SC)* held that ponds which were specially designed for the purpose of growing prawns is a plant. The assessee was a company doing business of 'Aqua Culture' and it grew prawns in specially designed ponds. The assessee was claiming that the ponds had to be specially designed and constructed and therefore they were tools to business of assessee. The Supreme Court appreciated the fact that the ponds in question were not natural and they were constructed / specially designed by assessee for prawn farming. Applying the functional test, it was held that as ponds were specially designed for rearing/breeding of prawns, they had to be treated as tools of business of assessee and depreciation was admissible on those ponds. The impugned decision once again lays down the emphasis on the functional test for deciding the character of a particular asset.

Non-user of an asset forming part of block of assets

With effect from A.Y. 1989-90, we have concept of block of assets for allowing depreciation. On purchase of a new asset which falls in one of the existing block of asset, the addition is made to the block of assets and the asset discarded from any particular block is reduced from the block of assets. As such, the individual identity of any particular asset is lost. In such a situation, a question comes up as to whether the depreciation will be allowable in respect of some of the assets of a particular block of assets, which are not actually used during the year.

As mentioned above, since the individual asset loses its identity and becomes part of the block of assets, the depreciation shall be allowed in respect of the block of assets. As long as some part of the block of assets has been used during the year under consideration, there should not be any difficulty to claim depreciation in respect of the entire block of assets. A counter question comes as to then what is the relevance of the use of asset and the date on which the asset is put to use. It is to be noted that the user of the asset has to be established only in the year of acquisition of a particular asset. Once it has been used in the year of acquisition, then in subsequent years, the depreciation is admissible without much emphasis on the user of the asset. This is almost a settled position. However, such question comes up on regular basis and therefore it is felt necessary to be covered here. Some useful reference for this proposition can be made to the decisions of the Bombay High Court in the cases of *CIT vs. G. R. Shipping Ltd. – ITA No. 598 of 2009 (Bom. HC) ; CIT vs. Sonic Hiochem Extraction P. Ltd. 94 CCH 99 (Bom.)* and also Mumbai Tribunal in the case of *DCIT vs. Boskalis Dredging India (P) Ltd. 53 SOT 17 (Mum)*

Depreciation on Intangibles

Clause (ii) of sub section (1) of section 32 provides for depreciation on know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature being intangible assets. The words any other business or commercial rights of similar nature have expanded the scope of the qualifying assets and many such intangible assets have been held to be eligible for depreciation. The readers may take note of some of such assets which have been held to be eligible for depreciation.

In the case of *CIT vs. Smifs Securities Ltd. 348 ITR 302 (SC),* the Supreme Court held that goodwill is an intangible asset and eligible for depreciation. Similarly the following decisions have held that depreciation is allowable for the respective assets as mentioned - *Techno Shares & Stocks Ltd. vs. CIT 327 ITR 323 (SC) - Stock Exchange Card. DIT vs. HSBC Asset Management India Pvt. Ltd. 228 Taxman 365 (Bom.) for SEBI Registration Fees ; ACIT vs. GKN Sinter Metal P. Ltd. 153 ITD 311 (Pune Trib)* – One time Licence Fees ; Medicorp Technologies India Ltd. – (2009) 30 SOT 506 (Mad) Srivastan Surveyors P. Ltd (2009) 318 ITR 283 (Chennai Trib.) *ACIT vs. Real Image Tech P. Ltd. 120 TTJ 983 (Chennai Trib)* – Non Compete Fees.

Payment made to retiring partners as compensation on retirement is held to be goodwill and accordingly eligible for depreciation in the case of Pr. *CIT vs. Swastik Industries (2016) 240 Taxman 510 (Guj)(HC).* Similarly in the case of *Triune Energy Services P. Ltd. vs. Dy. CIT 129 DTR 422 (Delhi)(HC)*, it has been held that in a case where the business is purchased as a going concern, excess amount paid over the net asset value of the business is goodwill and eligible to depreciation.

Rate of Depreciation on computer peripherals

Appendix I provides for higher rate of depreciation on computer hardware and software as compared to the other plant and machinery. Due to this, a question frequently comes up as to whether the computer peripherals like printers, modems, routers etc. are eligible for higher rate of depreciation as being essential part of computer hardware system.

This seems to be almost a settled position now and there are many tribunal decisions to support the contention that these computer peripherals are integral part of computer system and accordingly eligible to higher rate of depreciation. Reference can be made to the decisions of the Delhi High Court in *CIT vs Birlasoft Ltd. ITA 1284/2011 Dated:- 15-12-2011* and Tribunal decisions in the cases of *Hapag Lloyd India P. Ltd. vs. DCIT 117 DTR 113 (Mum) ; ACIT Vs. H T Media Ltd. 43 CCH 516 (Del.) ; Ushodaya Enterprises Ltd. vs. DCIT 155 ITD 701 (Hyd.) ; IBAHN India (P.) Ltd. vs. Dy.CIT (2016) 157 ITD 382 (Mum) etc.*

Car Registered in Partner's / Director's name

One more frequently raised issue is about the allowance of depreciation in the case of firm / private companies where the car is registered in the names of partners / directors of the company but the payment is made from the firm's bank accounts and EMIs are also paid from the firm's accounts in case of a car loan. The car is accordingly reflected in the balance sheet of the firm / private company but in the records of RTO it is registered in the partner / director's names.

This is also a settled position that in such a situation, virtually the owner is the firm / private companies and the names of the partner / directors is in their representative capacity. Accordingly the depreciation is allowable to the firm / company. Many decisions are available on the subject. Just for reference one can look at the decisions in *CIT vs. Aravali Finlease Ltd. 341 ITR 282 (Guj); Edwise Consultants P. Ltd. vs. DCIT 45 CCH 392 (Mum. Trib.)*

Conclusion

There are innumerous issues which arise on the above subject of Tax Audit. The issues are at times complex and require thorough understanding of the facts and also the law. An attempt has been made in this article to cover some of such issues. However, the fact remains that the issues dealt herein are not and cannot be exhaustive.

I would like to express my heartfelt thanks to the Journal Committee for giving me this wonderful opportunity on the subject. This really pushed me to revisit many of the topics which are as such known but needs to be refreshed time and again since the law keeps on moving in some direction or other. Let me admit that I was the biggest beneficiary in the entire exercise. I wish the readers a very happy reading and also wish all the very best for the busy audit season ahead.

CA Paresh Clerk

Issues in Tax Audit – Part 2 [Clauses 21 to 41]

Clause 21 to 41 of Form 3CD typically involve disclosures which by and large become the subject matter of thorough scrutiny during the assessment proceedings. The tax auditor's responsibility, therefore, while applying professional judgment, multiplies manifold. Ensuing paragraphs deal with some of the practical issues which the tax auditors need to address while conducting the tax audit; for brevity, clauses of significance are discussed.

Clause 21 : Part (a) of this Clause requires reporting of, inter-alia, expenditure debited to Statement of Profit and Loss, being in the nature of capital, in the nature of penalty or fine for the violation of any law in force or expenditure incurred for any purpose which itself is in violation of any existing law.

Insofar as capital expenditure is concerned, the tax auditor has to apply his/her professional judgment as to whether a particular expenditure gives rise to any enduring benefit to the assessee or is incurred merely to maintain the profit generating apparatus. There is no straight jacket method for identifying the nature of such expenditure since it varies with the nature of business of each assessee. A simple example would be of expenditure incurred on construction of office building for a manufacturing concern would fall under the category of capital expenditure whereas for a concern engaged in real estate, the same would fall as revenue expenditure forming part of work in progress or stock-in-trade. Courts have always gone into the purpose of incurring such expenditure having regard to the nature of the business of the assessee concerned. In any event, where the disclosure is required for such items, the assessee is entitled to claim depreciation on such asset forming part of the respective block. Therefore the risk of disallowance is reduced to that extent.

Common instances under capital expenditure v. revenue expenditure are:

i. In case of royalty expenditure, in order to decide its nature as capital or revenue, regard should be had to the technical know-how agreement which underlines the scope of facility being used, its tenure, exclusivity clause, use after expiry of agreement term, etc. – *Alembic Chemical Works Ltd. vs. CIT (Appeals) [1989] 177 ITR 377/43 Taxman 312 (SC).*

   When ownership in the intellectual property rights or in the licences is transferred, any expenditure incurred thereon would be a capital expenditure. Rights for a limited purpose or limited period, the royalty paid for use of technical information would be in the nature of revenue expenditure.*[Honda Siel Cars India Ltd. vs. CIT (SC) (82 taxmann.com 212)].*

ii. For treatment of software expenditure, it is pertinent to examine as to whether expenditure is for application software or mere upgradation of existing software. This also needs further analysing on the basis of functional testing as laid down by *Amway India Enterprises [2008] 111 ITD 112 (DELHI) (SB).*

iii. It is well established proposition that the trail run expenditure is that of capital in nature and the expenditure incurred thereafter is allowable as revenue expenditure; though, in the accounts, the expenditure upto commercial production is capitalised. However, now in the light of the following Para 8 of ICDS V on "Tangible Fixed Asset", even for the tax purpose, the expense incurred after the conduct of test runs and experimental production but before the commencement of commercial production is to be treated as capital expenditure:

"the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure."

As far as expenditure on penalty or fine for violation of any extant law is concerned, the tax auditor should first examine the relevant law under which payment of particular sum is paid to the concerned authority by way of penalty or fine. *[Prakash Cotton Mills (P.) Ltd. vs. CIT [1993] 201 ITR 684/67 Taxman 546].* However, it need not always be purely penal in nature but in most cases, it is compensatory in nature, i.e. interest for delayed payment of statutory dues. Some unusual examples are:

i. In the case of *ITO v. Reliance Share & Stock Brokers (P.) Ltd. [2014] 51 taxmann.com 215,* the Mumbai Tribunal held that the consent fees paid by the assessee to SEBI is not penal in nature since the 'violation of law' was not established and it was paid pursuant to the filing of consent application to SEBI.

ii. Where the assessee is not in any way at fault and still the penalty had to be paid for the preservation of title to the goods, etc., it could be regarded as laid out or expended wholly and exclusively for the purposes of business. For example, where the assessee had bona fide purchased bills of landing and other shipping documents from certain parties in respect of imports from Africa and later on, it was found that the imports were unauthorised and were liable to be confiscated, and had to be cleared on payment of a penalty, the amount paid was held to be allowable.

[CIT vs. Pannalal Narottamdas & Co. [1968] 67 ITR 667 (Bom.)]

In nutshell, in order to arrive at a conclusion whether or not any expenditure has been incurred by an assessee for any purpose which is an offence or which is prohibited by law, mere nomenclature as a "penalty" in an Act may not be conclusive. The true nature of the impost may be different. As held by the Apex Court in the case of Prakash Cotton Mills (P.) Ltd. (supra), auditor is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost, notwithstanding the nomenclature of impost as given by the statute to find whether it is compensatory or penal in nature.

Clause 21 : Part (b) of this Clause deals with amounts disallowable u/s. 40(a)(i) and 40(a)(ia) for non-compliance with provisions for Tax Deducted/Collected at Source (TDS/TCS). The disallowance is called for when required TDS is not deducted and paid or TDS deducted but not paid within the time limits prescribed u/s. 200(1).

i. Common issue that every assessee faces is regarding TDS on year-end provisions. In most of the cases, the provisions are made in compliance with Accounting Standards and based on contractual obligations. However, in the absence of specific sum and identified payee, no TDS is required to made. *[Mahindra and Mahindra Ltd. vs. DCIT (ITA No. 8597/Mum/2010, order dated 06/06/2012)* and *Pfizer Ltd. v. ITO(TDS) (ITA No. 1667/Mum/2010, order dated 31/10/2012)].*

ii. Another issue that has been lingering around for quite a long time is the applicability of TDS provisions in respect of sums 'actually paid' during the year and not remaining 'payable' as at the year-end. Initially, the Allahabad High Court ruled that provisions of Section 40(a)(ia) are not attracted in respect of sums 'paid' during the year and are applicable only for year-end liabilities. However, this view was subsequently dissented with by various high courts, viz. the *Tube Investment India Ltd vs. Asstt. CIT [2010] 325 ITR 610 (Mad.),* followed by *CIT vs. Crescent Export Syndicate [2013] 216 Taxman 258 (Cal.), P.M.S Diesel vs. CIT [2015] 374 ITR 562/59 taxmann.com 100 (P & H), CIT vs. T. Kuruvilla [(2016)(242 Taxman 139 (Ker)], Ryatar Sahakari Sakkare Karkhane Niyamit vs. ACIT [(2016)(383 ITR 561) (Kar)].* Recently, settling the dust, the Supreme Court in *Palam Gas Service [(2017) (394 ITR 300)(SC]* affirming the view of Punjab & Haryana High Court, in *P.M.S. Diesels vs. CIT [2015] 374 ITR 562/232 Taxman 544/59 taxmann.com 100,* held that word 'payable' occurring in Section 40(a)(ia) not only covers cases where amount is yet to be paid but also those cases where amount has actually been paid.

In view of this, the tax auditor needs to report the disallowance u/s. 40(a)(i)/(ia) for sums paid/payable where TDS is not deducted and/or after deducting the same has not been paid.

iii. Provisions of Section 40(a)(i)/(ia) do not apply to the cases of short deduction, since this Section applies only when tax has not been deducted or, after deduction, has not been paid. Many times, a short deduction results on account of difference of opinion regarding applicability of specific TDS provisions, viz. 194C or 194J or 194H, etc. however, courts have taken a view that such short deduction does not warrant disallowance u/s. 40(a)(ia). *[CIT Vs. S.K. Tekriwal (361 ITR 432) (Cal), CIT v. Kishore Rao & Others (HUF)(387 ITR 196)(Kar HC)].*

iv. TDS on payment by foreign bank's Indian branch to its overseas head office is not required to be deducted and hence, disallowance of such payment under Section 40(a)(i) is not valid.[DBS Bank Ltd. v. Deputy Director of Income-tax (66 taxmann.com 173)]

v. TDS on payments made by assessee to its non-resident subsidiary - if this payment is in nature of reimbursement, without any mark up or income embedded in same, it would not be subject to TDS requirements. *[Manugraph India Ltd v. DCIT(69 taxmann.com 400)].*

Clause 21 : Part (d) of this clause requires disclosure of expenditure covered u/s. 40A(3)/40A(3A) read with Rule 6DD for which payments are not made by way account payee cheque/draft/electronic clearing system. Recently, the Supreme Court has admitted SLP in Rajmoti Industries [(2017)(245 Taxman 338)(SC)] against the High Court's ruling that when payment exceeding Rs. 20,000 was made by assessee through crossed cheque and not by account payee cheque, it amounted to non-compliance of Section 40A(3).

A question arose whether merely on basis of book entries, it could be said that there was a payment of cash in contravention of Section 40A(3). It was held that where there is no cash payment, say, a barter or like, the provisions of Section 40A(3) will have no application.

Clause 21 : Part (h) of this Clause requires the tax auditor to report amount inadmissible u/s. 14A, being incurred for earning of exempt income. Over the period of more than a decade, disallowance u/s. 14A has been the staple ground for litigation for most of the assessees earning dividend income. This has been especially as an aftermath of Bombay High Court's decision in *Godrej & Boyee Mfg. Co. Ltd vs. Dy. CIT [2010] 194 Taxmann 203 (Bom).* At the same time, different theories have also evolved, substantially reducing the quantum of disallowance u/s 14A. The assessee therefore may demonstrate its various contentions as under in order to avoid/reduce the disallowance u/s. 14A:

i. First and foremost test for applying Section 14A is to verify whether the assessee has actually earned any exempt income during the year under consideration. In the absence of earning of any exempt income, no disallowance u/s. 14A read with Rule 8D could be made. *[Cheminvest Ltd. vs. CIT (2015)(378 ITR 33)(Del HC) followed by Redington (India) Ltd. vs. Addl. CIT (392 ITR 633)(Mad HC) and Delhi Tribunal Special Bench in ACIT vs. Vireet Investment (P.) Ltd. (82 taxmann.com 215)].*

ii. Most celebrated contention is that where the assessee has sufficient owned/interest-free funds to cover the investments generating exempt income, no interest disallowance could be made applying Rule 8D(2)(ii). This presumption has to be applied as on the Balance Sheet date *[CIT vs. Reliance Utilities & Power Limited (313 ITR 340) (Bom.) and followed and in CIT vs. HDFC Bank Ltd. (366 ITR 505)(Bom) and affirmed in HDFC Bank Ltd. vs. DCIT (83 ITR 529) (Bom).*

iii. For the purpose computing disallowance u/s. 14A read with Rule 8D, investments held as stock-in-trade should be excluded is the view expressed by the Bombay High Court in CIT vs. India Advantage Securities Ltd. (380 ITR 471)(Bom) followed in HDFC Bank Ltd. reported in (383 ITR 529) and thereafter by the *Punjab & Haryana High Court in PCIT vs. State Bank of Patiala (391 ITR 218)(P&H), CIT vs. G K K Capital Markets (P.) Ltd. (392 ITR 196)(Cal HC).*

iv. Investments held in order to retain control over group companies, i.e. investments strategic in nature should not be considered for the computation of disallowance under Rule 8D(2)(ii) and (iii). This is in the light of *Cheminvest Ltd. vs. CIT (378 ITR 33)(Del), JM Financial Ltd. [IT Appeal No.4521 (M) of (TMum), Garware Wall Ropes Ltd. vs. Addl. CIT (65 SOT 86/46 taxmann.com 18), Interglobe Enterprises Ltd. vs. Dy. CIT [IT Appeal Nos, 1362 (Delhi) of 2013, 1032/Del/2013 and 1580/De1/2013], Binani Industries Ltd. [IT Appeal No.l44 (Ko1.) of 2013], EIH Associated Hotels Ltd. IT Appeal No.1503 & 1624 (Mds.) of 2012].*

Clause 21 : Part (i) of this Clause requires reporting of interest disallowable under proviso to Section 36(1)(iii). With effect from AY 2016-17, the said proviso has been amended to exclude interest on borrowings incurred for extension of existing business. Therefore, from AY 2016-17, any interest on borrowing applied for acquisition of an asset needs to be capitalised and to claim depreciation thereon. On the other hand, for the purpose of accounting, the criterion of 'qualifying asset' still holds good and therefore, to such extent there appears difference in treatment of interest for other than qualifying assets. ICDS IX on "Borrowing Costs" deals with this aspect and accordingly, appropriate disclosure disclosure in this regard will have to be made under ICDS.

Clause 25 : Any amount of profit chargeable to tax under Section 41. Few significant aspects for consideration under this Clause are:

i. When liability is written back in books because it remained unclaimed, but the claim is not barred by operation of law would be treated as remission/cessation u/s. 41.

ii. No cessation of liability can be postulated until the matter is pending in appeal with the higher authorities. *[CIT vs. Hindustan Housing and Land Development Trust Ltd (161 ITR 524) (SC)].*

iii. When debt becomes barred by time, the right to enforcing in court lapses. But, that does not mean that the liability comes to an end. Therefore, Section 41(1) is not attracted, if the liability becomes time barred and has not been written backAugust 8, 2017.

Clause 26 : Payments under Section 43B

Certain deductions are available only on payment of expenses in the previous year in which such sum is actually paid by the assessee.

Significant aspects for consideration are:

i. As per Circular no. WSU/9(1)2013/ Settlement of January 8, 2016, the availability of extension period, i.e. grace period of 5 days has been dispensed with. Accordingly, contributions if any, deposited beyond the statutory period of 15 days from the end of the relevant month have been reported as delays. However, the said contributions deposited by the employer on or before the due date for filing of return of income would make the claim allowable u/s. 43B.

ii. Deduction under Section 43B can be availed where the due date for filing of return of income is extended and payments are made upto the extended due date.

iii. Actual payment does not mean only payment in cash/cheque/DD, etc., even payment of VAT by using input VAT credit (i.e. set-off) and payment of excise duty or service tax by using CENVAT credit is payment. *[CIT vs. National Standard Duncan Limited (134 Taxman 563) (Cal.)].*

iv. Interest payable for delayed payment of indirect taxes are not covered by Section 43B(a) *[CIT vs. Orient Beverages Ltd. 117 Taxman 106 (Cal.)].*

v. Unutilised Cenvat credit/Modvat credit/ VAT credit balances is not to be regarded as amounts paid. *[MarutiUdyog Ltd. vs. Dy. CIT (92 ITD 119) (Delhi)].*

vi. Pre-deposit of excise duty demanded for hearing of appeal is payment of duty and not merely a deposit. Therefore, such pre-deposits should be regarded as payment of tax and reported as such against Clause 26.

Clause 27(b) : Income or expenditure of prior period credited or debited to the profit and loss account.

It is essential to understand the meaning of "Prior period items" which are those material charges or credits which arise in the previous year as a result of errors omissions in the preparation of the financial statements of one or more previous years.

Expenditure relating to earlier year arising during the year on the basis that the liability materialised or crystallised during the year then it will not be considered as prior period items. *[SMCC Construction India Ltd. 38 taxmann.com 146 (Delhi)].*

Further, Change in accounting estimate is not a 'prior period item' as it is not the correction of an error.

The tax auditor will take into consideration all items of expenditure or income reflected in the financial statements as prior period items. In addition, it may through scrutiny of expenses, ascertain any item which too is required to be disclosed under this Clause.

Clause 28 : Property, being shares of a company not being a company in which the public are substantially interested received under section 56(2)(viia)

Significant aspects to be considered are:

i. Bonus shares are shares received 'without payment' and not 'without consideration'. Thus, section 56(2)(viia)(i) is not attracted in case of receipt of bonus shares. *[CIT vs. Dalmia Investment Co. Ltd. 52 ITR 5670. (SC)]*

ii. Allotment of rights shares cannot also be taxed under section 56(2)(viia)(ii). However, in case of renunciation of rights shares, the provisions of section 56(2)(viia)(ii) can be invoked in the hands of the recipient company/firm. *[Khoday Distilleries Ltd. vs. CIT. 176 Taxman 142. (SC)]*

Clause 29 : Consideration for issue of shares under Section 56(2)(viib)

Significant aspects to be considered are:

i. Where a company is widely held company at the time of receipt of consideration but is converted to a closely held company at the time of allotment of shares - status of company at the time of receipt of consideration is relevant and not its status at the time of allotment of shares. Therefore, since the company was not closely held company at the time of receipt of consideration, no taxability under this Clause arises.

ii. Where consideration was received from a non-resident who became a resident at the time of allotment – the residential status at the time of receipt of consideration by company is relevant and not at the time of allotment. Therefore, as the person from whom the consideration was received is non-resident at the time of receipt of consideration, no taxability under this section arises.

Clause 31 requires to provide particulars of each loan or deposit taken or accepted for an amount exceeding the limit specified under Section 269SS as also about repayment of loan or deposit exceeding the limit specified in Section 269T. With effect from July 19, 2017, the requirements under this Clause are modified to include payment by way of advance in relation to transfer of an immovable property, whether or not the transfer takes place (specified advance). This is in the light of recent amendments to Sections 269SS and Section 269T. Further, particulars in relation to section 269T, for repayment of loan or deposit or specified advance, is also to be given by the recipient of such loan or deposit or specified advance which has been repaid, which, hitherto, was to be given only by the payer.

Clause 32 : Details of change in shareholding of a Company in which public is not substantially interested - The provisions of Section 79 were introduced to check the malpractice of covering of losses in a company to reduce the incoming shareholders tax liability.

i. Expression not less than 51% of voting power used in Section 79 indicates that in order to invoke provisions of said section, only voting power is relevant and not shareholding pattern. Therefore, change of shareholding between the existing shareholders inter-se does not attract Section 79. *[CIT vs. AMCO Power Systems Ltd (62 taxmann.com 350)(Kar)].*

ii. Where voting power of assessee company had been unconditionally acquired by a company in which public is substantially interested, assessee company would become a company in which public was substantially interested; assessee-company's claim of brought forward losses would be allowed under Section 79. *[CIT vs. Tata Petrodyne Ltd (60 taxmann.com 81).]*

Clause 34 : Broadly, this Clause requires the tax auditor to report on compliance with the Tax Deducted at Source ("TDS") or Tax Collected at Source ("TCS"). It mainly requires to state whether the assessee is required to deduct/collect and if so, to furnish particulars as also about submission of returns for TDS/TCS. The auditor is required to comment on whether the assessee is liable to pay interest for non-deduction/collection or non-payment.

This Clause casts an onerous responsibility on tax auditors and requires to adopt an elaborate audit procedure.

The tax auditors should ensure (restricted for TDS) :

1. To determine the applicability of the related provisions of TDS with regard to the assese; to consider judicial pronouncement while taking a particular view for the applicability and if need be, make an appropriate disclosure therefor.
2. To obtain a copy of TDS returns to base verification of details given under the Clause.
3. In view of different nature and expenses like repairs and maintenance, professional fees, advertising and sales promotion expenses, etc., it is imperative to review Trial Balance is identify ledger accounts and scrutinise to ascertain whether TDS is required to be deducted, the related section under which it is to be deducted and is deducted accordingly on appropriate amount at the applicable rate.

   It is possible that the tax under a particular section may have been covered by more than one expense head. Say, TDS for payment to contractors under Section 194C may be covered under repairs and maintenance expenses or advertisement expense or any other head. Thus, it is important to prepare a reconciliation between the expense head vis-à-vis the relevant section under which the tax is deducted.

   Further, under each relevant head, a reconciliation should be available for the aggregate expense/payment with the amount on which tax is deducted or deducted at a lower rate and in case not deducted the reason therefor. In fact, that is the key for the entire reporting under Clause 34(a).
4. Differences may be attributed to explanations like :
   i. Tax is required to be required to be deducted at a lower rate due to lower deduction certificate as per Section 197.
   ii. Amount does not exceed threshold limit as per the relevant section.
   iii. Tax is deducted at incorrect rates.
   iv. Tax is not required to be deducted on certain expenses
5. Also to reconcile for difference between amount on which the tax is deducted and the amount which is deposited with the Government.
6. Verify whether TDS Returns are filed within the prescribed due dates and reconcile the same with the TDS Challans to ensure that the liability indicated in books matches with the payment challans and returns.

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CA Nihar Jambusaria

MAT – Recent Controversies including MAT vis-a-vis Ind-AS

Provisions to levy Minimum Alternate Tax were inserted by the insertion of Chapter XII B by the Finance Act, 1987 with effect from 1-4-1988. The provisions have been subject to controversies right from the time they were enacted. Some controversies have been resolved while many of them continue to exist. There are contradictory decisions of the Tribunals and the courts on some issues. An attempt has been made to discuss some controversies including those created by the insertion of sub-section (2A) to section 115JB of the Income-tax Act, 1961 (Act) by the Finance Act, 2017 w.e.f. 1-4-2017 i.e. AY 2017-18.

1. Addition of expenditure related to exempt income

- The book profit of the company shall be increased by any expenditure relatable to any income exempt under section 10 (other than under section 10(38)) or Section 11 or Section 12 as per clause (f) of Explanation 1 to Section 115JB(2) of the Act.
- When AO records a finding that he is not satisfied with the correctness of assessee's claim in respect of expenditure incurred in relation to exempt income, he will resort to Rule 8D r.w.s 14A of the Act and make the disallowances under section 14A. Question whether disallowance calculated under section 14A read with Rule 8D of the Income-tax Rules should be *ipso facto* applied in computing the increase under clause (f) of Explanation 1 of section 115JB of the Act.
- There were Contrary views on the issue but recently it has been held that the expenses debited to the profit and loss account which have direct and proximate nexus with the exempt income credited to the profit and loss account have to be added back under section 115JB of the Act. The above decision was based on following principle i.e.

  a. Section 115JB of the Act is a complete code in itself.

  b. Assessing Officer does not have jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to section 115JB of the Act.

  c. Applicability of provisions of section 14A of the Act is confined to computation of tax liability under the five heads of income enumerated in section 14 of the Act under normal provisions contained in Chapter IV of the Act. The said section 14A cannot be extended and read into section 115JB of the Act, falling under Chapter XII-B of the Act.

2. Whether duty refund/subsidy which is in the nature of capital receipts not chargeable to tax can still be considered as part of the book profit under section 115JB

- Department has always tried to tax such capital receipts under section 115JB of the Act on the ground that the sums have been credited to the Profit & Loss account and treated as income and exclusion of these incomes (sums) for the purpose of computing book profit under section 115JB has not been specifically provided under Explanation below section115JB(2) of the Act.
- Let's examine Clause (ii) of Explanation 1 to section115JB which specifically provides that the amount of income to which any of the provisions of section 10 (other than the provisions contained in clause (38) thereof) apply is to be reduced from the Net profit, if it is credited to the Profit and Loss account. Thus it is seen that the legislature seeks to maintain parity between the computation of "total income" and "book profit", in respect of exempted category of income. If the said logic is extended further, an item of receipt which does not fall under the definition of "income" at all and hence falls outside the purview of the computation provisions of the Income-tax Act, cannot also be included in "book profit" under section 115JB of the Act.
- However, there are plethora of case laws which have held that subsidies in question are not in the nature of income. Therefore they cannot be regarded as income even for the purpose of book profits under section 115JB of the Act though credited to the profit and loss account and have to be excluded for arriving at the book profits under section 115JB of the Act.

3. Issues under MAT – Ind-AS provisions

Based on the MAT-Ind-AS Committee's recommendations, the Finance Act, 2017 amended the existing MAT provisions to provide a mechanism for computation of book profit for Ind-AS compliant companies. The amendments are effective from 1st April, 2017 i.e. FY 2016-17.

Following are the few issues –

3.1 Deferred Tax Adjustments as on Convergence Date

- One of the adjustments required under Ind AS on first time adoption is adjustment related to deferred tax. Corresponding debit or credit is adjusted to other equity / retained earnings.
- As per the Explanation to Section 115JB(2C) of the Act, the amount adjusted to other equity / retained earnings will be included in Transition Amount, which is subjected to MAT (1/5th for five years).
- Income tax or MAT is generally payable on profit before tax. Deferred Tax itself is a tax and any adjustments on account of deferred tax shall not be subjected to tax.
- Clause (h) to the Explanation to Section 115JB (2) of the Act itself provides that any amount of deferred tax or provision made thereof shall not be part of book profits. On similar logic, any deferred tax adjustments on transition to Ind AS shall also be ignored for calculation of book profits.
- The CBDT *vide* Circular No. 24/2017 dated 25th July, 2017, FAQ No. 5 clarified that any deferred tax adjustments recorded on transition date shall be ignored while computing Book Profits.

3.2 Revaluation of Fixed Assets on Transition

- As per the amended provisions of section 115JB of the Act, any amount credited to Retained Earnings on account of fair valuation of an asset on the transition date, shall be taxable at the time of its sale or disposal. As per the current provisions of the Act, depreciation on revaluation amount of the asset is required to be added back while computing book profit. This would lead to double taxation.

- Illustration –

Particulars	Where asset is fair valued at ₹ 1,000 w.e.f. transition date	Where asset is not fair valued at transition date
1-4-2015	1000	100
Less: Depreciation for 2015-16	100	10
W.D.V. on 31-3-2016	900	90
Less: Depreciation for 2016-17	90	9
W.D.V. on 31-3-2017	810	81
If the Asset is sold in FY 2017-18 for ₹ 1100		
Book Profit	290 (₹ 1100 - ₹ 810)	1019 (₹ 1100 – ₹ 81)
Adjustment u/s. 115JB	900	–
Total book profit	1190	1019

- Book profit is more by ₹ 171 where asset is fair valued at ₹ 1000 on first time adoption of Ind-AS as ₹ 171 provided as depreciation on ₹ 900 was not allowed as depreciation and ₹ 900 is added again on the disposal of the asset.
- The CBDT now clarifies *vide* FAQ No. 10 of Circular No. 24/2017 that the amount to be included in book profits while computing MAT liability would be the net amount after considering depreciation on such revalued assets provided in the books of account, but not allowed as deduction in computing book profit in the respective year,

3.3 Convergence date adjustments for Provision for Bad and Doubtful Debts

- The CBDT *vide* FAQ No. 6 of Circular No. 24/2017 clarifies that adjustments relating to provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.
- However, the issue may arise at the time when these provisions for bad debts are written back and credited to P/L account. As per Clause (i) of Explanation 1 to section 115JB of the Act, any amount withdrawn from any reserve or provision created and credited to P/L account shall be allowable provided the same amount was added back to book profits at the time where reserve or provision was created.
- Further clarification is required with respect to taxing the amount at the later stage when the bad debts are written back.

3.4 Convergence Date – Transition Date

- As per Explanation to section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting Standards reporting period as defined in Ind AS 101. However, the Memorandum explaining the provisions of the Finance Bill, 2017mentions that the adjustment as on the last day of the comparative period is to be considered. This leads to confusion as to which date should be considered for computing the transition amount i.e. 1st April at the start of the day or at the end of the day.
- The CBDT *vide* FAQ No. 3 of Circular No. 24/2017 clarifies that the First Time Adoption adjustments as of March 31, 2016 (i.e. the start of business on April 1, 2016 or equivalently, close of business on March 31, 2016) will be considered for computation of MAT liability for FY 2016-17 (AY 2017-18) and thereafter. The convergence date has been clarified to be March 31, 2016.

  Recently CBDT vide press release dated July 25, 2017 has invited comments on the proposed amendment to Section 115JB(2A). Some of the issues croping out them as as under:

3.5 In case fixed assets are acquired by issue of equity shares at premium, currently adjustment is allowed for such receipt of share premium

3.6. Purchase of an undertaking by issue of shares: Capital reserve would be created in case where value of equity shares issued is less than the value of undertaking. Such capital reserve would be considered as part of book profits for MAT

3.7 Issues may also arise when interest free advances are given to subsidiary company by holding company.

In short, notional debits and credits are leading to unintended MAT consequences.

Case Laws Index


CA Anish Thacker & CA Niraj K. Shah

HOT SPOT
Indirect transfer
– An important aspect of reorganisation

Taxation of cross-border acquisitions involving the transfer of shares of a foreign company which in turn have resulted in a change of ultimate holding of shares of an Indian company (hereinafter loosely referred to as **'indirect transfer'**) has been a subject of controversy over the last five odd years. Following the Supreme Court's favourable decision in the Vodafone case[1], the law was amended retroactively (with effect from 1st April, 1962) to tax such gains.

Explanation 5 to Section 9(1)(i) of the Act (introduced by the Finance Act, 2012) covers the indirect transfer of shares or interest in an Indian company or entity by providing that a share or interest in a company or entity registered outside India would be deemed to be situated in India if the share or interest derives value substantially from assets located in India. The provisions were introduced as clarificatory amendment in 2012 with retrospective effect from 1st April, 1962. Thus literally seen, the term indirect transfer is a misnomer as the language of the Explanation which is a deeming fiction does not deal with transfer at all. However, keeping in mind its popular usage, the term 'indirect transfer' is continued to be used in this article.

Since 2012, the indirect transfer provisions have been the subject matter of continuous debate and have significantly engaged offshore investors, such as public market funds and private equity funds that manage India-focused funds and / or deploy an India-focused investment structure. The concerns were manifold, ranging from (i) extra-territorial applicability of the provisions, (ii) double taxation of income where the offshore fund has paid tax on its India-sourced income, (iii) uniform application of indirect transfer provisions to all cases including genuine cases.

In order to allay the concerns of foreign investors, the then Prime Minister had in July, 2012 entrusted an Expert Committee ('EC') under the Chairmanship of Dr. Parthasarathi Shome, with the task of examining implications dealing with taxation of indirect transfer. On receipt of the EC's recommendations[2], the following provisions were introduced *vide* Finance Act, 2015:

- Prescribing the threshold for 'substantial' – Insertion of Explanation 6 to Section 9(1)(i) of the Act
- Small shareholders exemption – Insertion of Explanation 7(a) to Section 9(1)(i) of the Act

1. Vodafone International Holdings B.V. vs. Union of India and Anr. [2012] 341 ITR 1 (SC)
2. Draft report on retrospective amendment relating to indirect transfer issued by EC in 2012

- Proportionate basis of taxation – Insertion of Explanation 7(b) to Section 9(1)(i) of the Act
- Providing exemption for amalgamation / demerger which are tax neutral in home country– Insertion of Section 47(viab)/ (vicc) of the Act
- Prescribing reporting and penal obligations – Insertion of Section 285A and Section 271GA respectively

While substantive provisions had been enacted, the Government had indicated that the finer aspects and further clarifications would be provided by issuance of a circular and/or by notification of prescriptive rules. The Central Board of Direct Taxes **('CBDT')** on 28th June 2016 notified the following Income-tax Rules, 1962 **('Rules')**:

- Rule 11UB – Determination of fair market value **('FMV')**
- Rule 11UC – Determination of income attributable to assets in India
- Rule 114DB – Information/documents to be maintained and furnished by Indian concern (whose shares are being indirectly transferred)

In this article, we have attempted to acquaint the readers with the indirect transfer provisions and certain nuances related thereto.

Indirect transfer provisions – Whether extra-territorial?

The line between territorial and extra-territorial is difficult to comprehend in private as well as public international law.

'Extra-territorial' implies something along the lines of 'beyond territorial limits'. Therefore, a pertinent question that requires evaluation is whether the Act could extend to a transaction of sale of foreign shares outside India between two non-residents on the sole basis that such shares indirectly derive value substantially from Indian assets.

The power of the government to make laws having extra-territorial operation are available in the Constitution of India[3].

The Supreme Court of India[4] has held that in order to capture a transaction or event occurring outside India within the Indian tax net, a reasonable nexus of that transaction or event with India needs to be established. What constitutes 'reasonable nexus' is itself nebulous and a subject matter of interpretation.

From one viewpoint, it may appear that a transaction between two non-residents involving transfer of non-Indian assets/ property carried outside India should not, by itself, constitute nexus with India to bring the same within the Indian tax net, albeit such non-Indian property may derive its value substantially from Indian assets.

On the other hand, it may not be completely out of place if it is suggested that gains arising (albeit in a foreign jurisdiction) principally from a change in ownership of Indian assets, constitute some economic nexus with India. Accordingly it should be within the sovereign power of Indian Government to impose tax on such gains to the extent such gains are attributable to Indian assets. This is especially in cases where abusive, devious or oblique structures are deployed to reduce/ mitigate taxability in India and indirect transfer provisions are applied as an anti-abuse measure to bring the legitimate tax share due, to India.

The view that gains arising substantially from assets located in India constitute an economic nexus with India finds place in the Explanatory

3. Article 245(2) of the Constitution of India
4. GVK Industries vs. Union of India [2011] 332 ITR 130 (SC)

Memorandum to Finance Bill, 2012 which states that legislative intent of indirect transfer provisions was to tax gains having economic nexus with India, irrespective of the mode of realisation of such gains.

In the authors' opinion, countries could have rules / mechanism in place which may extend to transactions being implemented beyond their territorial jurisdiction if such transactions have reasonable nexus or are capable of having an impact in that country. In the present context, the 'substantiality' test as appearing in the indirect transfer provisions, to a certain extent, establishes some economic nexus of gains arising from indirect transfer transaction with value creation being made in India. Therefore the amendment to Section 9(1)(i) of the Act ought not be regarded as being extra-territorial especially in cases where artificial / devious structures are being deployed with a view to evade Indian tax. The other contrary view is strongly expressed but the view expressed above is in our opinion, the better view.

Certain countries like United States, China, Peru, Chile etc. also have similar provisions incorporated in their domestic tax laws wherein certain provisions of their tax laws extend beyond their territorial jurisdiction.

Scope of indirect transfer provisions

The indirect transfer provisions get attracted when following cumulative conditions are satisfied:

- There is a sale of shares or interest in a foreign company or entity;
- Such share or interest of a foreign company or entity derives value substantially from assets located in India as on the specified date[5] i.e. the value of Indian assets exceeds ₹ 10 crore and the same represents at least 50% of the value of all the assets owned by the foreign company /entity;
- Such foreign company / entity, the shares of which or the interest in which is being transferred, is not a Foreign Institutional Investor ('FII') or Category I / Category II Foreign Portfolio Investor ('FPI') registered with the Securities Exchange Board of India ('SEBI');
- The transfer does not qualify for the 'small shareholder exemption' as described in Explanation 7 to Section 9(1)(i) of the Act; and
- The transfer is not pursuant to an 'amalgamation' or 'demerger' within the meaning of Section 47(viab) and Section 47(vicc) of the Act.

Explanation 7(b) to Section 9(1)(i) of the Act restricts the scope of charge of tax only to the extent the gains are attributable to assets located in India based on the ratio of Indian assets vis-à-vis non-Indian assets.

Further, dividends declared and paid by an offshore company outside India in respect of shares deriving value substantially from Indian assets have been excluded from the provisions of indirect transfer[6].

Exclusion provided to investment in FIIs / FPIs

Unlike other foreign corporates which may indirectly hold a controlling stake in Indian assets, FIIs / FPIs are not strategic investors and pay income-tax (as applicable) on the sale of their investment in Indian listed companies. If the indirect transfer provisions were to be applied in the case of FPIs, it could lead to double taxation of same income firstly on the

5. Specified date is the last date of the accounting year preceding the date of transfer unless there is a variation of more than 15% between the value of Indian assets from last date of preceding accounting year and as on the date of transfer

6. CBDT Circular no 4 /2015 dated 26 March 2015

income earned on direct transfer of Indian securities and subsequently on the gains earned by investors of FPIs on transfer / redemption of shares / units in FPI. Given this, stakeholders had approached the government to seek clarity on the applicability of indirect transfer provisions on FIIs /FPIs.

In response to various queries / concerns raised by stakeholders, the CBDT had issued circular 41 of 2016 clarifying the scope and applicability of indirect transfer provisions. However, the CBDT circular merely reiterates / clarifies the prevailing indirect transfer provisions and failed to address the concerns around the scope and applicability of the indirect transfer provisions to foreign investment funds.

This created widespread controversy and angst amongst the relevant stakeholder which resulted in the Government keeping the aforementioned circular in abeyance and inserting two provisos to Explanation 5 to Section 9(1)((i) of the Act (*vide* Finance Act, 2017) so as to exclude FIIs and Category I and Category II FPIs from the applicability of indirect transfer provisions.

However, the language of the provisos create an ambiguity as to the manner in which indirect transfer provisions need to be applied in a situation where foreign investor holds both FII/ FPI investment as well as non-FII/FPI investment deriving substantial value from assets located in India.

A literal reading suggests that the exemption from indirect transfer provisions may also extend to transfer of non-FII/FPI investment (deriving value substantially from assets located in India) if the transferor also holds investment in entities registered as FII/FPI. However, such an interpretation may not be consistent with the Government's intention for exempting investment in FII/FPI entities from indirect transfer provisions and is therefore less likely than not to suceed in litigation.

Also, the second proviso only excludes investment in a company / entity registered as Category I and Category II FPI with the SEBI leaving out Category III FPIs[7]. The issue of taxation of same income being taxed at multiple levels would equally prevail in case of a transfer of share or invest in Category III FPIs. Therefore, the discrimination between Category I FPIs / Category II FPIs and Category III FPIs with regards to indirect transfer provisions not seem to be congruous for all categories of FPIs. There is a need to examine this incongruity once again.

Exemption for corporate reorganisation

In this dynamic world, corporate reorganisations have become an integral part of the new economic paradigm. Corporate reorganisation could be due to myriads of non-tax reasons like (a) better alignment of group /organization structure (b) ease in cash repatriation and pooling (c) better reporting and administration (d) enhancement of shareholder's value etc. In many countries (including India), internal reorganisations within the group are tax neutral.

Considering that internal reorganisation within a group does not normally result in any real income, one of the suggestions of the EC was to exclude internal reorganisations which are tax neutral in the home country, from indirect transfer provisions.

Accordingly, the Government of India *vide* Finance Act, 2015 inserted Section 47(viab) of the Act and Section 47(vicc) of the Act so as to exclude overseas amalgamation and demerger respectively from capital gains taxation subject fulfilment of the following conditions:

Amalgamation

- At least 25% of shareholders should continue in the amalgamated company;

7. Category III FPIs include investors such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices

- Such reorganisation does not attract capital gains tax in the home country of the amalgamated company.

Demerger

- At least 3/4ths of shareholders should continue in the resulting company;
- Such reorganisation does not attract capital gains tax in the home country of the demerged company.

Whilst, the section exempts any transfer of foreign company's share (deriving value substantially from Indian assets) in amalgamation /demerger from capital gains taxation, it is ambiguous whether such exemption would extend to the shareholders of such amalgamating or demerged company absent the specific mention of 'shareholder' in Section 47(viab) and Section 47(vicc) of the Act.

This ambiguity has been covered by CBDT in Circular No. 41 of 2016 (now in abeyance) which states that the exemption in case of overseas amalgamation / demerger would be restricted to the assets of amalgamated / demerged company only and the exemption would not extend to their shareholders. While the CBDT has kept Circular No. 41 of 2016 in abeyance as mentioned above, it could be garnered that the intention of the government seems to restrict the benefit only to the amalgamated / demerged company.

Although, exclusion of overseas internal reorganisation in the form of amalgamation / demerger from capital gains taxation is a step in right direction, it is difficult to logically understand the reason for not extending the exemption to shareholders of amalgamating / demerged company from indirect transfer provisions. This again is an area where a fresh look at the provisions may be desired and warranted.

Small Shareholders exemption

One of the recommendations of the EC was to exclude the category of small shareholders where the voting power or share capital of the foreign company (along with associate company) in the Indian company / entity is less than 26% during the preceding 12 months. This was to avoid undue hardship on small shareholders not having effective controlling interest in the Indian company / entity whose shares are being transferred indirectly.

The Government has accepted EC's recommendation in part and inserted Explanation 7(a) to Section 9(1)(i) of the Act which excludes the following cases from the applicability of indirect transfer provisions:

a. <u>Foreign company directly owning Indian assets</u> – Where the transferor or shareholder (whether individually or along with its associated enterprises), at any time in the 12 months preceding the date of transfer does not hold:

   – Right of management or control in relation to foreign company; and

   – Voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of foreign company.

b. <u>Foreign company indirectly owning Indian assets</u> – Where the transferor or shareholder (whether individually or along with its associated enterprises), at any time in the 12 months preceding the date of transfer does not hold:

   – Right of management or control in relation to foreign company; and

   – Right in, or in relation to, such company or entity which would entitle him to the right of management or control in the company or entity that directly owns Indian assets; and

   – Such percentage of voting power or share capital or interest in such company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, holding company that directly owns Indian assets;

It may be noted that the threshold of 26% as suggested by EC has been replaced with a de-minimus threshold of 5%.

Further, the term 'control and management' has not been defined and accordingly one may have to refer to the definition provided in various other sections of the Act viz., Section 6, Section 167, Section 92A etc.

Computation of gains attributable to Indian assets

As mentioned above, the deeming fiction provided under Explanation 5 to Section 9(1)(i) of the Act is restricted to only such gains that are attributable to the assets located in India. The manner of determining such proportionate gains are provided under Rule 11UC, as per following normative formula:

$$A \times \frac{B}{C}$$

Where A = Total gains arising from the transfer of shares, or interest in, the company or the entity computed in accordance with the provisions of the Act as if such share or interest is located in India

B = FMV of Indian assets as per Rule 11UB

C = FMV of all the assets of the overseas company / entity computed as per Rule 11UB

However, the proviso to Rule 11UC empowers the assessing officer to undertake his own computation if the transferor fails to provide information relevant for application of aforementioned formula.

The table below summarises, the manner of computing FMV of Indian assets which are subject to indirect transfer provisions as per Rule 11UB:

A. Valuation of Indian assets

	(A)	(B)	
Scenario	**Method of valuation**	**Liabilities to be adjusted**	**FMV**
Listed on a recognised stock exchange	Observable price[8] of the share	–	(A)
Listed on recognised stock (where there is direct or indirect right of management or control in the Indian company)	Market capitalisation on the basis of observable price5 excluding book value of liabilities	Book value of liabilities[9]	(A+B) / total number of shares of Indian company

8. Observable price is defined to mean the higher of the following:
   - the average of the weekly high and low of the closing prices of the shares quoted on the said stock exchange during the six months period preceding the specified date; or
   - the average of the weekly high and low of the closing price of the shares quoted on the said stock exchange during the two weeks preceding the specified date
9. Book value of liabilities means the value of liabilities as shown in the balance-sheet of the company, excluding the paid-up capital in respect of equity shares or members' interest and the general reserves and surplus and security premium related to the paid up capital. It needs to be noted that preference share capital is not specifically excluded

	(A)	(B)	
Scenario	**Method of valuation**	**Liabilities to be adjusted**	**FMV**
Unlisted shares	As determined by the merchant banker/ accountant by any internationally accepted valuation method on arm's length basis	Liabilities considered in (A)	A+B
Interest in partnership firm (firm) / association of persons (AOP)	As determined by the merchant banker/ accountant by any internationally adopted valuation method excluding liabilities considered therein	Liabilities considered in (A)	Value of the firm/ AOP = A + B Interest of partner/ member in partnership firm/AOP = (i) amount equal to capital allocated amongst each partner based on capital, + (ii) residual value [A + B – (i)] to be allocated in accordance with agreement of firm/ AOP in the event of dissolution or, in the absence of any agreement, in profit sharing ratio
Any other asset	Price it would fetch if sold in the open market as determined by the merchant banker/ accountant excluding the value of liabilities considered in the price	Liabilities considered in determining price	A + B

B. Valuation of foreign company deriving value substantially from shares / interest in Indian company

	(A)	**(B)**	
Scenarios	**Method of valuation**	**Type of liability**	**Fair Market Value of Assets**
Transfer is between non-connected persons	Market capitalisation on the basis of entire sale consideration	Book value of liabilities[9]	A + B
Transfer is between connected persons and share of the foreign company is listed on a recognised stock exchange	Market capitalisation on the basis of observable price5	Book value of liabilities9	A + B

	(A)	(B)	
Scenarios	**Method of valuation**	**Type of liability**	**Fair Market Value of Assets**
Transfer is between connected persons and share of the foreign company is not listed on a recognised stock exchange	FMV as determined by the merchant banker/ accountant by any internationally accepted valuation method	Liabilities considered in determining FMV	A + B

Although, the Rules do provide guidance for computing proportionate gains attributable to tax in India in various scenarios, some aspects have attracted widespread criticism a few of which are:

(a) Prescribing FMV to be based on valuation certificate from an accountant or merchant banker even in case the overseas transaction are between unrelated parties which is often a matter of commercial negotiation rather than valuation;

(b) No clarity on whether accounts are to be prepared as per iGAAP, IndAS or any other reporting standards;

(c) Absence of guidance as to how the Rules would be applied in case of transfer of shares in a listed entity which is not listed as on the specified date;

(d) Practical challenge as to how the shareholders in foreign companies will obtain information relating to downstream Indian subsidiaries;

(e) No logical rationale of adding back the liabilities to arrive at the valuation.

Interplay with Double Taxation Avoidance Agreement ('DTAA') provisions

Section 90(2) of the Act permits an assessee to opt to be governed by the provisions of the Act or DTAA, if any signed between India and home country of the taxpayer, whichever is beneficial.

The DTAAs entered into by India with other countries have different formulations for taxation rights on capital gains. These may be divided, mainly, into four categories;

(i) India has right of taxation of all capital gains as per its domestic law (e.g., US and UK);

(ii) India has right of taxation of all capital gains as per its domestic law but at concessional rates (e.g., Mauritius and Singapore);

(iii) India has right of taxation of capital gains arising on alienation of shares of an Indian company (in most treaties);

(iv) India has right of taxation of capital gains arising on alienation of shares of an Indian company only if the transferee is a resident of India (e.g., Netherlands)

Most of the DTAA signed with India do not recognise the concept of indirect transfer and a plain reading may exempt such gains from being taxed in India, rendering the indirect transfer provisions redundant.

The interpretation of the indirect transfer provisions in case of a treaty jurisdiction, i.e., country with which India has a DTAA had been dealt with in the case of Sanofi[10] wherein the Andhra Pradesh High Court, while analysing the provisions of India-France DTAA, protected gains arising from indirect transfer of Indian shares from Indian taxes by ruling that indirect

10. Sanofi Pasteur Holding SA, France vs. Department of Revenue, (2013) 354 ITR 316 (AP)

transfer provisions do not override provisions of DTAA. This view was also articulated by the then Indian Finance Minister in his speech in Parliament during discussion on Finance Act, 2012 amendments.

Having said this, the General Anti-Avoidance Rules ('GAAR') provisions under Chapter X-A of the Act (w.e.f. 1st April, 2017) would still apply. Accordingly, the beneficial position under DTAA may not be available where it is established that the main purpose was to obtain so called 'tax benefit' and other prescribed conditions are satisfied. However, GAAR provisions apply prospectively, and pre-2017 investments may enjoy grandfathering from GAAR provisions and beneficial provisions under DTAA, if any, could be explored.

Nevertheless, recently[11], the Union Cabinet has given its approval for signing a multilateral convention to implement the outcome of OECD/ G20 Base Erosion and Profit Shifting ('BEPS') project[12]. Amongst various Action Plans identified under the BEPS project, Action Plan 6 specifically aims to prevent granting of DTAA benefits in inappropriate circumstances.

Therefore, beneficial provisions under DTAA, if escaped from GAAR applicability could be subject to scrutiny post implementation of the multilateral convention.

Reporting obligations and penal consequences

The Finance Act, 2015, also introduced Section 285A of the Act, which casts reporting obligations in the case of an indirect transfer on the 'Indian concern'.

Rule 114DB prescribes that information relating to indirect transfer should be electronically submitted to jurisdictional tax officer in Form 49D. The time limit and penalty for non-furnishing of information within the prescribed time are as follows:

Type of Transfer	Time limit for reporting	Penalty under section 271GA in the case of failure to report
Directly or indirectly transferring the rights of control and management in relation to Indian concerns	Within 90 days from the date of the transfer	2% of the value of transaction
Any other case	Within 90 days from the end of the financial year in which transfer has taken place	₹ 5,00,000

Further, the Indian concern is required to maintain, for a period of eight years, various information like shareholding details, financial statements, contracts /agreement evidencing the transfer of the immediate holding company, intermediate holding company and the ultimate holding company, information relating to the decision or implementation process of the overall arrangement of the transfer, the asset valuation reports, details of tax paid outside India and business operation information in respect of the foreign company and its subsidiaries.

The obligation is extremely onerous on the Indian concern considering the exhaustive list of information and documentation, thus, it is farfetched that the Indian concern will be able to collate all such information. Further, many funds through multi-layer structures invest in Indian companies and thus due to confidentiality may

11. Press release issued by Government of India dated 17 May 2017
12. BEPS project is an nations to help Governments protect their tax bases by increasing transparency and improved data in order to evaluate and stop the growing disconnect between where money and investments are made and where profits are actually reported for tax purposes by multinationals

not provide details of the group structure of the funds to the Indian companies. Therefore, a simple reporting obligation providing basic details like details of transferor and transferee, subject matter of transfer etc. should have been adopted.

The Rule also provides that where there are more than one Indian concerns that are constituent entities of a group, the information may be furnished by any one of the Indian concerns designated by the group, such designation being communicated to the Assessing Officer. This would avoid multiple reporting of the same transaction by entities within the same group.

While it is clear that the reporting obligations as per Section 285A of the Act apply only when the deeming fiction as per Explanation 5 to Section 9(1)(i) of the Act is attracted, it is unclear whether the Indian concern would be required to undertake reporting obligations where the gains are claimed to be not taxable in India applying the relevant DTAA.

Considering that DTAA may be subject to GAAR and/ or provisions of the Multilateral convention and keeping in mind the quantum of penalty prescribed, the Indian concern may want to conservatively report the transaction to the jurisdictional tax officer.

Separately, the transferor of the share or interest in the foreign company / entity, is required to obtain and furnish along with the return of income a report in Form No. 3CT duly signed and verified by an accountant, providing the basis of apportionment in accordance with the formula and certifying that the income attributable to assets located in India has been correctly computed. It may be noted that there are no penal consequences in case of failure to obtain and furnish Form No. 3CT.

Purchaser – Caught in the dark?

The stringent indirect transfer provisions may also daunt the purchaser group. This is on account of the wide scope of provisions of Section 195 of the Act which require tax to be deducted at source by *"any person responsible for paying to a non-resident"* without specifically carving out non-resident payer from it's applicability.

While it could be argued that Section 195 of the Act should be extraterritorial to the extent it is interpreted to apply to non-resident payers[13], however, Supreme Court[14] has held that withholding tax provisions could be applied extra-territorially.

Having said this, it is well settled now that provisions of Section 195 of the Act would need to be read in conjunction beneficial provisions of relevant DTAA. Accordingly, where DTAA does not subject indirect transfer to tax in India, the withholding tax provisions should not be attracted to the payer.

In a case where DTAA benefits are not available /applied, the purchaser may be required to, inter-alia, undertake the following compliances under the provisions of the Act:

a. Obtain a tax deduction account number from the Income-tax department;

b. Ascertain the tax liability in the hands of the seller. This would require the buyer to undertake computation in accordance with complicated set of indirect transfer provisions. Alternatively, the payer could approach the Indian Revenue Authority ('IRA') and obtain order under Section 195(2) of Act on the amount of tax to be withheld on payment to be made to the seller. Else, buyer could rely on the indirect transfer computation prepared by the seller and seek necessary tax indemnity to protect itself from any potential tax challenges by the IRA with regards to the indirect transfer computation.

13. Section 195 of the Act, being machinery provisions, are governed by the limits of 'enforcement jurisdiction'. Accordingly, to the extent enforcement provisions cannot apply, it could be argued that the machinery provisions should also not apply

14. CIT v. Eli Lilly & Co [2009] 312 ITR 225 (SC)

c. Based on the above, deduct the appropriate amount of tax. In case no cash consideration is involved, the buyer would need to obtain necessary amount from the seller for the purpose of depositing the same with government treasury;

d. Deposit the amount deducted with the credit of Central Government. Practically, tax can be deposited only in electronic mode and from Indian banks only. Therefore, buyer would need to make necessary arrangement such that taxes are paid electronically to the Government treasury;

e. Subsequently, the details of tax deducted and deposited would need to be reported by submitting withholding tax statements in Form 27Q;

f. Lastly, an automatically generated withholding tax certificate would need to be downloaded from the Income-tax portal (i.e. TRACES) and shared with the seller.

Failure to comply with the above could result in initiation of penalty equivalent to the amount of tax not deducted under Section 271C of the Act and / or interest under Section 201(1A) of the Act calculated at the rate of 1% for every month or part of a month from the date on which such tax was deductible to the date on which such tax is deducted.

Additionally, Section 195(6) of the Act further requires the payer to furnish information / relating to the payment made to another non-resident in prescribed form i.e. Form 15CA and / or accountant's certificate in Form 15CB even in case the subject payment is not chargeable to tax.

The requirement of furnishing the information / certificate as per Section 195(6) of the Act was introduced pursuant to relaxation of exchange control regulations wherein overseas payments were permitted to be made on furnishing of appropriate certificate from a Chartered Accountant. Therefore, by necessary implication, compliance with Section 195(6) of the Act would be relevant only when payment is being made by a resident to a non-resident and not when a non-resident is making payment directly to another non-resident outside India. Unfortunately, the section does not explicitly provide any such exclusions and on a literal interpretation, a view is possible that the non-resident payer would also be required to furnish information / certificate as prescribed under Section 195(6) of the Act. Practically, at present, information /certificate in Form 15CA / Form 15CB could be submitted only in electronic mode which mandatorily requires a PAN to be obtained by the non-resident payer.

Non-compliance with the aforementioned requirement attracts penalty of ₹ 1,00,000 under Section 271I of the Act.

Thus, the Purchasers need to deal with these issues and take some practical decisions when purchasing shares / interest in a foreign company which attracts indirect transfer provisions.

Conclusion

On summary, while the indirect transfer provisions now spell out their scope and the computational aspects are now not as ambiguous, some concern areas do remain and are significant enough to warrant Government's attention.

Be that as it may, any corporate reorganisation where a foreign company holds assets located in India is the seller will need examination of the 'indirect transfer provisions' and therefore this is an aspect of corporate reorganisation that cannot be ignored.

On the reporting front, the Government could have taken a more practical view. This would help the Government in achieving its tax agenda of creating non-adversarial tax regime, certainty and clarity in tax laws and substantial reduction in tax litigation, apart from supplementing its "Ease of doing business" agenda.

Ms. Prerna Singh

Demonetisation – Challenges in Cashless Economy

Introduction

Demonetisation of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. In the current context it is the banning of the 500 and 1,000 denomination currency notes as a legal tender.

The Government's stated objective behind the demonetisation policy are as follows;

1. attempt to make India corruption free,
2. curb black money,
3. control escalating price rise,
4. stop funds flow to illegal activity,
5. make people accountable for every rupee they possess and pay income tax return.
6. attempt to make a cashless society and create a Digital India.

There is a background to the current decision of demonetisation of 500 and 1000 rupee notes. The Government has taken few steps in this direction much before its November 8, 2016 announcement.

1. As a first step the Government had urged people to create bank accounts under Jan Dhan Yojana. They were asked to deposit all the money in their Jan Dhan accounts and do their future transaction through banking methods only.
2. The second step that the Government initiated was a tax declaration of the income and had given October 30, 2016 deadline for this purpose. Through this method, the Government was able to mop up a huge amount of undeclared income.

However, there were many who still hoarded the black money, and in order to tackle them; the Government announced the demonitisation of 500 and 1000 currency notes.

The demonitisation policy is being seen as a financial reform in the country but this decision is fraught with its own merits and demerits.

What is Demonitisation

Demonitisation is the withdrawal of a particular form of currency from circulation. Through demonitisation the old currency is replaced by the new currency or a currency circulation is blocked.

Demonitisation' as defined in Investopedia is as follows: *"Demonitisation is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency"*[1].

1 http://www.investopedia.com/terms/d/demonetization.asp

International Examples and Trends

- **USA**

The Coinage Act of 1873 demonetized silver as the legal tender of the United States, in favour of fully adopting the gold standard. Several coins, including two-cent piece, three-cent piece, and half dime were discontinued. The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a five-year economic depression throughout the country. In response to the dire situation and pressure from farmers and silver miners and refiners, the Bland-Allison Act remonetized silver as legal tender in 1878.

- **European Union**

An example of demonitisation for trade purposes occurred when the nations of the European Union officially began to use the euro as their everyday currencies in 2002. When the physical euro bills and coins were introduced, the old national currencies, such as the German mark, the French franc and the Italian lira were demonetized. However, these varied currencies remained convertible into Euros at fixed exchange rates for a while to assure a smooth transition.

- **Zimbabwean**

In 2015, the Zimbabwean Government demonetized its dollar as a way to combat the country's hyperinflation, which was recorded at 231,000,000%. The three-month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the U.S. dollar, the Botswana pula and the South African rand as the country's legal tender in a bid to stabilize the economy.

- **India's Demonitisation**

1. Earlier it was done in **1946** with the complete ban of ₹ 1000 and ₹ 10000 notes to deal with the unaccounted money i.e. black money.
2. Second time it was done in **1978** by Government headed by Morarji Desai, when ₹ 1000, ₹ 5000 and ₹ 10000 notes were demonetized.
3. In **2016**, the Indian Government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills.

Indian Demonitisation 2016

The Government's action was to combat India's thriving underground economy on several fronts:

- **Eradicate counterfeit currency**

This move will stop the circulation of fake currency. Most of the fake currency put in circulation is of the high value notes and the banning of 500 and 1000 notes will eliminate the circulation of fake currency.

- **Fight tax evasion (only 1% of the population pays taxes)**

This move will help the Government to track the black money. Those individuals who have unaccounted cash are now required to show income and submit PAN for any valid financial transactions. The Government can get income tax return for the income on which tax has not been paid.

The demonetisation policy will force people to pay income tax returns. Most of the people who have been hiding their income are now forced to come forward to declare their income and pay tax on the same.

Even though deposits up to ₹ 2.5 lakh will not come under Income tax scrutiny, individuals are required to submit PAN for any deposit of above Rs 50,000 in cash. This will help the income tax department to track individuals with high denominations currency.

- **Eliminate black money gotten from money laundering.**

The ban on high value currency will also curb the menace of money laundering. Now such activity can easily be tracked and income tax department can catch such people who are in the business of money laundering.

- **Eliminate terrorist-financing activities.**

The move will stop funding to the unlawful activities that are thriving due to unaccounted cash flow. Banning high-value currency will rein in criminal activities like terrorism etc.

- **To promote a cashless economy.**

The ultimate objective is to make India a cashless society. All the monetary transaction has to be through the banking methods and individuals have to be accountable for each penny they possess. It is a giant step towards the dream of making a digital India.

Immediate Effects on Indian Economy

- **Alternative Funds**

Soon after the announcement, people rushed to buy gold, a demand that drove prices up, in some cases even to a 60% premium, prompting the tax authorities to conduct surveys, according to the Business Standard newspaper. The Government emphasized the need to furnish PAN (Indian Permanent Account Number) card details on purchases for accountability purposes, and many jewellery shops that were flouting the norms came under crackdowns. Simultaneously, rumours of a gold ban started to float, which led to agencies ramping up the volume of gold imports – to around 100 metric tons during November, the highest since 2015, as reported by Reuters.[2]

- **Alternative Payment Avenues**

Many Indians switched to alternative payment avenues – a big deal in a country of 1.2 billion with only 25.9 million credit cards and 697 million ATM cards as of July 2016.

The biggest gainers were mobile wallet companies that offer ease of transactions through a large network of partners. Alibaba (NYSE:BABA)-backed Paytm saw a sevenfold increase in overall traffic and a 10-fold jump in money added to Paytm accounts. It also saw the number of transactions double to five million a day.

App downloads for Paytm increased by 300%. Paytm rival MobiKwik also saw its app downloads quadruple and a 20-fold increase in money added to the wallets, MobiKwik Founder & CEO Bipin Preet Singh, told CNBC-TV18 on November 13.

Prepaid cash cards were another option that customers found useful, and that meant good news for companies like ItzCash.

Other alternatives include mobile payments systems linked to e-commerce businesses like Ola Money, FreeCharge, Flipkart Wallet. Ola Money, the payment portal for popular transportation app Ola Cabs, reported a 1500% jump in money added to the accounts in less than four hours[3].

- **Trading and stocks[4]**

Interest in Bitcoin also spiked: Sandeep Geonka, co-founder of Zebpay, told Investopedia that his bitcoin exchange was now adding about 50,000 new users per month. "We are seeing an increased demand for bitcoin and India clearly

2 http://www.investopedia.com/terms/d/demonetization.asp

3 http://www.investopedia.com/terms/d/demonetization.asp

4 http://www.investopedia.com/terms/d/demonetization.asp

has shortage of supply, making the demand and lack of liquidity push up prices of bitcoin as compared to global exchanges," said Coinsecure CEO Mohit Kalra. The virtual currency was currently trading at INR 55,735 in India in November, compared to $712, or approximately INR 47,725 (Coindesk) elsewhere.

- **Jan Dhan Accounts**

This move has generated interest among those people who had opened Jan Dhan accounts under the Prime Minister's Jan Dhan Yojana.

Long-Term Effects

- Over 3 trillion rupees, or over $44 billion in old currency, was deposited with Indian banks in just the first week after the demonitisation. There was concern that the uncertainty and short-term liquidity squeeze would take some momentum off the Indian economy, the fastest-growing in the world; in particular, sectors like real estate, notorious as a harbour for cash dealings and black money, were expected to take a hit, with "luxury property prices dipping by as much as 25-30%," said Ashwinder Raj Singh, CEO of Residential Services, JLL India.
- But experts believed any slowdown would only be short-lived once the systems adjusted to the new normal, especially if the Government heeded calls to lower interest rates by groups like the Federation of Indian Chambers of Commerce and Industry (FICCI). Credit rating agency India Ratings & Research maintained its GDP growth forecast for India at 7.8% for FY17, albeit with a downward bias.
- This step is considered as the biggest cleanliness drive against the black money in the history of Indian economy. As per RBI, 87% transactions in India are cash transactions and this loophole is used by corrupted people to build a parallel economy with unaccounted money[5]. This parallel economy helps in terror financing which in turn hampers the growth and development of country. Currently high-values notes account for total value of 86% of the notes in circulation in India. It is expected that this step will help in reducing the fiscal deficit of India and promote the cashless economy in India which can be easily monitored.
- Economists predict that over the long term, demonitisation will lead to reduced interest rates and also cause an increase in investment in the real estate sector. The smallest action is better than the greatest intention-even though demonitisation was announced with good intentions-it affected the lower and middle class heavily as compared to the affluent class.
- There is no doubt that e-transaction will strengthen the people of India. It will bring the transparency in the economy. We can sure hope a good future with this decision. The black money must be arrested at any cost. We should learn quickly the e-transaction process to make paperless economy.

Demerits of Demonitisation

There are many cons of demonitisation also, for instance:

1. Inconvenience to masses

   The announcement of the demonization of the currency has caused huge inconvenience to the people. The sudden announcement has made the situation become chaotic.

2. Business affected

   It has deeply affected business. Due to the cash crunch, the entire economy has been

5 https://gradeup.co.

made to come to a standstill. Local traders and shopkeepers are facing problem. It is expected that it will affect the SME sector in India.

3. Poors affected adversely

Many poor daily wage workers are left with no jobs and their daily income has stopped because employers are unable to pay their daily wage.

4. Glitchy implementation

The Government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes. It is also finding it difficult to put new currency into circulation. The 2000 rupees note is a burden on the people as no one likes to do transaction with such high value currency. Some critics think it will only help people to use black money more easily in future.

5. Loss to Economy

Further, many people have clandestinely discarded the demonetized currency notes and this is a loss to the country's economy.

Critical Analysis of Effects on Economy

A retrospective look on whether demonitisation was necessary is an exercise of futility. What is more significant is understanding the impact it will have on the economic, social and political situation in the country. ₹ 1000 and ₹ 500 notes made up roughly 85% of the circulating cash in the country.

- **Expected impact on fake currency**

A study by the National Investigation Agency and the Indian Statistical Institute, in 2016, estimated that fake Indian currency notes in circulation have a face value of ₹ 400 crore. This is an incidence of fake currency of 0.022%[6].

The scale of counterfeiting of the Indian rupee is not out of line with what is seen in other countries, and the procedures adopted worldwide to address this include investigative actions against counterfeiters, phased replacement of old series of notes with new notes that have better security features, etc.

De-monetisation is generally not seen as a tool for dealing with counterfeiting. We must also not forget that the counterfeiters will now get to work on the new 500/2000 rupee notes, while India will likely never do a de-monetisation again.

- **Expected impact on unaccounted wealth a.k.a. "black money"**

The analysis presented in the Finance Ministry's White Paper on Black Money, 2012[7], shows that, on an average, the amount of cash seized during raids by income tax authorities is 4.88 per cent of total undisclosed income admitted in those cases. This data is from more than 23 thousand warrants executed.

Even if this decision inflicted a 100% loss upon holders of unaccounted cash, this would imply a loss of 4.88% of their total unaccounted wealth, which is not much of a shock for those with such wealth. If, as is more likely, the demonetisation has imposed a 40% loss upon holders of unaccounted wealth (who suffer a 40% discount when laundering the money), this implies a loss of about 2% of unaccounted wealth.

- **Expected costs[8]**

Cash is a store of value (white or black), but it is also a medium of exchange. Most people in India only transact with cash. More than 90 percent of shops accept only cash or very short-term credit.

6 http://www.business-standard.com/article/economy-policy/demonetisation-understanding-the-event-impact-narrative-and- meaning-116120400175_1.html

7 http://finmin.nic.in/reports/whitepaper_backmoney2012.pdf, page 47

8 http://www.business-standard.com/article/economy-policy/demonetisation-understanding-the-event-impact-narrative-and- meaning-116120400175_1.html

Large number of labourers and small value suppliers are paid in cash. **Demonetisation of these notes is a large adverse monetary shock, perhaps the largest ever such shock in world history.**

The co**nstraints of ATM recalibration and currency printing are leading to a long transition period.** The Centre for Monitoring of Indian Economy has estimated that a few elements of the first-round impact give a reduction of GDP of around ₹ 1.3 lakh crore; the total impact will be higher owing to the multiplier effect, the hysteresis associated with the monetary shock, the impact upon expectations, etc[9].

- **Who bears the costs?**

While there is much talk about the GDP impact of this decision, a unique feature of this episode is that there may considerable other costs that fall disproportionately upon the poor.

The rich have access to electronic payments, employees who will stand in queues to obtain cash, and savings that are used to cope with a decline in income. The poor lack all these. If a poor person suffers an income shock, or is not able to get medical treatment, the consequences are enormous for the individual, but the GDP impact may be negligible. **In terms of welfare implications, these costs matter a lot more than the impact on GDP**.

- **Approach to comparing benefits and costs**

The benefits are primarily in the form of losses inflicted upon those with black money, while costs are imposed on legitimate economic and social activities. It seems that the economic costs of this decision are likely to outweigh its economic benefits. Some have compared this decision with a surgical strike, but it is more like a nuclear strike. The nuclear option has been exercised before exhausting other options. Although measures to help people disclose their undisclosed incomes have concluded, the efforts to directly or indirectly curb illegality have barely begun. This raises concerns about the wisdom of using this lever of demonetisation.

- **Supreme Court judgment while handling PILs filed against the govt's decision took a balance unbiased approach and opined the following:**

"You (Centre) can have a surgical strike against blackmoney but you cannot have surgical strike against the people of the country," a bench comprising Chief Justice T. S. Thakur and Justice D. Y. Chandrachud said, pointing to the long queues at banks and ATMs".

"We will not be granting any stay," the bench bluntly said while observing that "the real purpose is to force those who have hoarded cash at home to deposit in bank and explain the source of money. But in the process, collateral damage is being faced by common men who have to stand in queue for hours together."

The succour to the Modi Government came when the bench remarked that the Centre's objective was not "illegal" but appeared to be "laudable", though there was inconvenience and "collateral damage" to the common people by the so-called "surgical strike" against the blackmoney and fake currency[10].

Facts and figures

Up to 97%[11] of the demonetised bank notes have been deposited into banks which have received a total of ₹ 14.97 trillion ($220 billion) as of December 30 out of the ₹ 15.4 trillion that was demonetised. This is against the Government's initial estimate that ₹ 3 trillion would not return to the banking system.

9 http://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=2016-11-21%2015:12:31&msec=360

10 http://www.firstpost.com/politics/supreme-court-refuses-to-stay-demonetisation-but-says-cant-have-surgical-strike-against-common-man-3106384.html

11 http://timesofindia.indiatimes.com/toi-features/business/97-of-scrapped-notes-deposited-with-banks-as-on-dec-30-report/articleshow/56344692.cms

Of the ₹ 15.4 trillion demonetised in the form of ₹ 500 and ₹ 1000 bank notes of theMahatma Gandhi Series, ₹ 9.2 trillion in the form of ₹ 500 and ₹ 2000 bank notes of the Mahatma Gandhi New Series has been recirculated as of 10 January 2017, two months after the demonitisation[12].

Forecast of GDP growth rate

Global analysts cut their forecasts of India's GDP growth rate due to demonetisation[13]. India's GDP in 2016 is estimated to be US$2.25 trillion, hence, each 1 per cent reduction in growth rate represents a shortfall of US$22.5 billion (₹ 1.54 lakh crores) for the Indian economy[14]. According to Societe Generale, India's quarterly GDP growth rates would drop below 7% for an entire year at a stretch for the first time since June 2011[15].

LET's analyze and peer into the long term consequences of this decision that it will expedite the process of making India a *"cashless economy"*.

An additional objective was appended by Govt. after making the announcement of Demonistisation viz 'to *make India a cashless society*'. It reflects poorly on the Government's policymaking process to add such a big objective after beginning implementation of such a momentous decision. If this was indeed an objective, much preparation should have gone in *before* the decision was announced. There is no evidence of such preparation.

Cash is expensive as a store of value – it gives negative returns and is amenable to loss and theft. Many households are forced to save in cash or other similar assets, because they do not have convenient and reliable access to the modern financial system. It would be beneficial for many households and enterprises to move most of their store of value to financial instruments, but only if considerable comfort around security, convenience and reliability of these instruments is created.

The evidence on superiority of electronic payments over cash as a medium of exchange is limited and context-specific. There is evidence to support making Government- to-citizen payments cashless, but even there, the last mile problems of helping the recipients' access and use this money has yet to be solved. Several research studies show the poor quality of the last mile banking network in India.

For transactions involving only private parties, the case for going cashless for payments depends on the context. It would be nice to have more cashlessness, but not in all situations, not for all persons, and not for all purposes. Cash has many inherent advantages, and in many contexts, cashless instruments are not superior to cash. For example, in an area with poor telecom connectivity, cash is more convenient. People should have the freedom to choose, depending on their context.

This Government push to make Indians go cashless looks like a large, centrally planned effort in mission mode. This high modernist approach is ill suited for this objective. Going from cash to cashless is a vague and complex problem with unclear pathways. Storing money in financial instruments and using it to make day-to-day payments requires regular, reliable and secure access to these instruments. This is not a simple product that can be launched

12 http://www.business-standard.com/article/economy-policy/rbi-replaces-60-of-demonetised-notes-rs-9-2-lakh-cr-new- notes-in-system-117011801335_1.html

13 http://www.livemint.com/Politics/gG3pF45hFU53GyXE1BwIuJ/Cash-crunch-Analysts-cut-India-GDP-growth-forecast.html

14 http://www.imf.org/external/pubs/ft/weo/2016/02/weodata/weorept.aspx?sy=2014&ey=2021&scsm=1&ssd=1&sort=coun try&ds=.&br=1&pr1.x=26&pr1.y=13&c=534&s=NGDPD&grp=0&a=

15 http://www.cnbc.com/2017/01/17/india-demonetisation-news-india-could-see-four-consecutive-quarters-of-below-7- percent-growth.html

across the country overnight, but a sophisticated service that needs to take into account the infinite variety of needs of households and enterprises. At its core, it is a personal choice that each one should make in their own time. If this choices, and immature systems, are forced down their throats, many persons would recoil from electronic payments.

Government is inherently bad at seeing the complexity of such issues. It is likely to unleash a badly designed mission mode programme, without understanding the package of services required to actually make cashless store of value and payments work. The programme would also be hampered by the persistent capacity constraints of Government of India. When the objective is so complex, it is better for the Government to be modest, and only play an enabling role.

The way most societies have gone to less-cash is through slow, careful, detailed policy work. The willingness to use coercion at an early stage of India's journey is troubling. As an example, consider shops accepting card payments. There are about 1.5 crore retail shops, but only about 14.6 lakh card devices. Should more shops accept cards? No one can decide this from the vantage point of policy-making in Delhi or Mumbai. There is no ideal number of card-enabled shops. If there are impediments preventing this, Government and RBI should remove those impediments. If the right conditions exist, and if both consumers and shopkeepers feel the need, this number will increase.

We in India have a relevant experience from an episode that began in mid-1990s - the dematerialisation of shares. If Government had forced households to immediately turn all their share certificates to demat shares, many may have turned their backs on the share market. They enjoyed the comfort of holding those certificates, and were not sure about the new system. Since they were given a choice, over a period of time, most of them opted for demat shares. They saw the advantages, and made their choice. This happened in a context where the numbers were quite small (the number of shareholders), but it still took about ten years. In that example, luckily, the new system worked out fine. But it could have failed to deliver. There were many risks of things going wrong. In such a situation, coercing households to switch to demat would have been unfair. The same holds true of the idea to go cashless, and at much larger scale.

An optimal shift from cash to electronic store of value and payments will happen if enabling conditions are created, within which people can make their choices. Government's primary role in this transition should be to unleash competition and innovation, while addressing problems through regulations and grievance redress. Government also has a role in ensuring provision of enabling infrastructure, which includes Aadhaar, telecom network, broadband network, etc.

There is an enormous mismatch between expectation and reality on this issue. Some people seem to assume that India could quickly go cashless during this period of remonetisation of cash. This premature use of coercion, in an under-developed payments ecosystem which has suffered from major errors of policy for decades, speaks poorly of the policy process. It is problematic to cite this complex, long-term aspiration to reduce use of cash as some kind of mitigant for this sudden note ban.

The financial lives of poor households are very different from those of middle class and the rich in one crucial aspect - intensity and frequency of financial transactions involving cash. The ratio of financial turnover to assets held, during a given period, is much higher for poor households. Financial turnover is the total value of all financial transactions, i.e. putting money in or pulling money out from any informal or formal financial instrument.

Think of a middle class household with one salaried person earning ₹ 600,000 a year, with total financial investments worth ₹ 10, 00,000.

From the bank account, money is withdrawn and spent, or drawn down through card/online payments, or transferred into an investment instrument. If this person has a credit card, each purchase on the card would create two financial transactions of equal value - drawing credit, and repaying credit. Other than this, there may not be much "push and pull" in the person's financial life; only simple drawing down or investing up. She may occasionally take loans or switch across investment instruments. Financial turnover during a year is likely to be much lower than the total value of the financial assets owned. The cash portion of the transaction value may be smaller yet.

Research on the financial lives of the poor was presented in a landmark book, *Portfolios of the Poor: How the World's Poor Live on 2 dollars a day,* Collins et. al. 2009[16]. It found that the ratio of total transaction value to asset value for poor households is quite large. For the median rural poor household in India, financial turnover was about 33 times the year-end asset value. This shows that even though, at a given time, a poor household has only a small asset base and small savings, they are intensively transacting. They are using a range of informal (e.g. loan to or from friends) and formal instruments (e.g. microfinance loans) - to frequently put in and take out money.

Why do they do this? Most poor households have small, irregular and unpredictable incomes. This forces them to do high frequency financial transactions in order to smooth their consumption. They are transacting intensively in the process of cash-flow management, to transform irregular income flows into a stable flow of consumption from day to day. When the poor flounder in this high wire act, they may go hungry. These are not the concerns of the middle class: their income is much more stable, and they can use their savings as a buffer. I fear that much of the commentary on demonetisation lacks an appreciation of this distinction.

It is wrong to think of poor households as accumulating incomes and then going to bank branch to exchange or deposit/withdraw it. Most poor households cannot afford to do that, as their savings are small. They must actively manage incomes and consumption, using high frequency financial transactions. To the extent these transactions involved ₹ 500 and ₹ 1000 notes, the demonetisation decision has temporarily restricted the ability of poor households to engage in their consumption smoothing.

The argument about credit relationships holds true for some time and for certain contexts. All poor people are consumers, and many are also producers (eg. wage laborers, artisans, etc). Most of the credit relationships of poor households as consumers are for the short term, as evidenced by the high turnover in credit relationships. Further, as producers, their ability to work on credit is limited by their small or non-existent savings. There are about 14.5 crore casual labourers in India, who may not be able to work on credit for long. As the remonetisation is dragging on, credit relationships are coming under stress.

It is true that credit is integral to the high frequency financial transactions of the poor. This does not mean that there is depth to cope with much larger requirements of credit on a sustained basis. Lenders might sense problems of solvency, start demanding deleveraging, and choke off credit access.

These questions, about the financial activities of the poor, must be seen in the context of the large monetary shock which has become a large negative GDP shock. The poor who work as casual laborers, especially in cash-intensive businesses, may see their employment opportunities drying up. There are reports of informal labour markets failing to generate work for many laborers who rely on such markets. There is anecdotal evidence about many small and medium scale industries and construction sites temporarily closing down. Similarly, for

16 Portfolios of the Poor: How the World's Poor Live on $2 a Day, Daryl Collins, Jonathan Morduch, Stuart Rutherford, Orlanda Ruthven, Princeton University Press, 20-Apr-2009.

farmers, this is the time when crop is brought to the market and new sowing is done. Although farmers with small holdings usually do not have marketable surplus, they need cash during the sowing season. Landless labourers may be affected because farmers with medium to large landholdings are not able to get cash to pay them for sowing work.

India has a shadow economy. Many poor people work in enterprises outside the official, tax-paying economy. Many of these enterprises are doing legal activities without paying taxes. So, in that sense although they are breaking tax laws, they are not criminal enterprises as such. Consider a small brick manufacturing unit that is totally outside the tax purview. The business is cash-intensive. It is doing something illegal - not paying taxes.

However, it is a a productive enterprise employing people. It is in the shadow economy, and must be brought into the official economy. This means that it must be made to pay taxes and penalties, but it need not be shut down. The note ban may have pushed this cash-intensive enterprise into failure. The outcome is that the production and employment are lost, and nothing accrues to the taxpayer. This is not beneficial in any way, and may be particularly harmful to poor people working in such enterprises.

The poor are also more vulnerable to frauds and swindles that are thriving in the present environment of enormous uncertainty. The unbanked are likely to be mainly the poor, and the unexpected ban on exchange of notes has created a desperate situation for them. It is easy to say that they should open bank accounts. But in the present situation of uncertainty, we are hearing reports of people resorting to desperate measures even to protect a part of their savings. There are many reports of this happening in remote areas.

India being a vast, multi-terrain country, with uneven presence of banking facilities, there are many regions with poor access to banking facilities. The transaction cost of having to make the trek to a bank branch multiple times to exchange or withdraw cash even once is quite high as percentage of a household's income. We have heard stories about people living in remote villages in hilly areas having to rely on others to get notes exchanged, and taking losses in the process. So, for a subset of the poor living in remote locations, the costs may be even larger.

It is quite likely that the costs of this decision on the poor will be significant, and some poor people might suffer disproportionally. Poor households have no black money and did nothing to deserve this.

Some commentators have argued that although the note ban has created a shock to money supply, the central bank could soon restore money supply through use of monetary policy instruments, such as open market operations, rate cuts, etc. It is argued that the Monetary Policy Committee will, in some weeks, see the adverse shock to GDP, and vote in favour of large cuts in interest rates, which will solve the problem.

However, it is important to keep in mind the distinction between India's money supply in banks and India's money supply in cash. On 8th November, there was ₹ 10.5 trillion of demand deposits, and over ₹ 96 trillion of time deposits, which are vastly greater values than the ₹ 14.2 trillion of 500/1000 rupee notes which was disrupted. The electronic money supply was not disrupted; it was the cash money supply that was disrupted. This matters because cash is a preferred medium of exchange ("money") for most transactions. The constraint today is the shortage of cash. To overcome the disruption, cash must be restored into the hands of people. None of the instruments of monetary policy do that. They only enhance liquidity in the banking system. Cash still needs to be printed and dispensed through bank and postal networks.

Conclusion – Macro and Micro Assessment

Demonitisation is a very good tool to arrest black money. It was implemented with a very good intention to make India free of parallel black economy and black money.

But the actual problem was in implementation. A macro and micro assessment were needed for ground level problems.

Strengths:

- **Black Money and Counterfeits:** Two primary reasons were touted for this drastic move – to hit at black money and to check counterfeits. This move left the parallel black economy choked and gasping. The elimination of fake currency is inevitable, and one also hopes that a check is well in place while these notes are routed through banking channels. It will be a tremendous achievement.
- **Countering Terror & Crime:** While the Government has clearly pointed out the use of fake currencies by terror outfits, some have spoken about uses of cash by criminals. This move has already halted many terror operations and has the potential to force a significant shift in the terror infrastructure.

  As the large chunk of Hawala money is delivered to separatist leaders and local politicians to fuel protesters, the four-month-long unrest in the valley is also getting wiped out in the absence of cash inflow, security agencies believe. Besides, the lack of Hawala money would also hit the Maoists activities and other insurgent groups across India, especially in the northeast region, intelligence officials said.
- **Timing:** No timing is perfect, but in hind-sight, the timing seems obvious. If we connect the dots, the very first decision of Modi Govt was to establish a SIT on Black Money. Then came the massive roll-out of the Pradhan Mantri Jan-Dhan Yojana (PMJDY) nearly completing all citizens' access to bank accounts. The next was crack down on hoarders /foreign accounts (approximately ₹ 80,000 Cr was collected). Then followed the Income Declaration Scheme, with a deadline of 30th Sept 2016. Another window of opportunity was given to people to declare their amassed wealth. (₹ 65,000 Cr collected) Now, if you still have the Black Money, the Government will ensure that either you declare and become mainstream or else face the hammer. Commendable chronology!
- **Reformist Stance:** Demonetisation is not a foolproof measure, but it attacks the black money problem with unprecedented force and at multiple layers. If the objectives are achieved through sound implementation, this will show a strong signal about India's anti-corruption drive and also its reformist stance.

Weaknesses:

- **Preparedness:** The entire banking and postal system were caught unaware. The Government says that it will now take two more weeks to configure all ATMs. The situation is testing in small towns, most ATMs are still not dispensing cash, and some branches are easily running out of cash. It seems that the planning ahead of such massive event lacked matching preparedness.

  But the Government could not have stashed large cash in banks and reconfigured ATMs. It would have led to the corrupt getting wind of the announcement and overnight getting much of their illicit wealth converted.
- **Logistics:** There is always the risk that the infusion of the new currency notes is not sufficient to satiate the demand for currency. The Government has fixed certain limits, which for all practical purposes seem moderately small.
- **Unaccounted Wealth:** There are many means to store wealth; in cash, foreign currency, gold, real estate, and several other instruments. Out of which hard cash is relatively unattractive as it earns

a negative rate of return, whereas, other modes of unaccounted wealth are laundered, and becomes much harder to identify. So this strike is only on black-cash and not on the entire parallel economy per se.

- **Cutting Corruption:** Demonetisation does not promise that there will not be any future corruption. Crooks are always creative and will find ways to circumvent this demonetisation. At best, this is a reset button.

- **Sluggish Economy:** This process would increase bank deposits with an obligation to pay interest. Can the financial institutions mobilize these funds fast enough and be able to disburse as loans, especially in a sluggish economy?

Opportunities:

- **Windfall Profit:** The Chief Economic Advisor of the Government has argued that this decision would lead to transfer from black money holders to the RBI and then to the Government. For the cash that does not return, should the RBI simply decide to reduce its liabilities and create a profit? It won't be unwise in this exceptional case of the fight against black money but may send wrong messages. RBI may take some time and carry the liabilities on its balance sheet for the foreseeable future but should not announce this in advance.

- **High cost of Future Crimes:** Cash facilitates crime because it is anonymous and big bills are easy to carry. By inflicting a cost, demonetisation cripples the ability to engage in future corruption. It is far easier indulging in crime with substantial cash in hand. The costs of crime will become much higher and will have an indirect but powerful impact on future corrupt practices committed with the help of currency.

- **Checks on Loose Sectors:** Black money spawns in an economy in areas where the checks and balances are weak and have larger cash component in their transactions like commodity hoarding and trading, movie production, campaign finance, and of course real estate. Since liquidity dries up, hoarders' and black-marketeers' holding power collapses leading to prices collapse. Demonetisation will result in a correction in these markets, either by a reduction in prices or a reduction in business. We will see the outcome in time to come. However, these corrections will move the market to equilibrium reflecting genuine demand and supply in the real economy.
- **Less-Cash Economy:** Cash greatly facilitates transactions and hence we should aim for a less-cash economy and not cash-less. A less-cash economy is an excellent balance between maintaining ease of financial operations and also curbing malpractices.
- **Financial Inclusion:** It also provides a boost to the Government's financial inclusion drive, pushing more households towards efficient banking and payment infrastructure.

Threats:

- **The Cost of Harassment:** A massive logistics exercise was undertaken causing countrywide panic and confusion. If the Government does not invest all its energies into replenishing and re-calibrating ATMs, festering inconvenience will lead to backlash and has potential to undo the intended good work. Daily wage earners, truck drivers don't have much time to stand in line every day. People can only do this for a limited time. It will also give the opposition a stronger opportunity to carry sustained attacks.

- **Lower Economic Activity:** Overall the adoption of electronic payment instruments is slow, and the infrastructure is weak. During the transition period, the shortage of the lubricant of economic activity disrupts the smooth working of the economy. As a consequence, in coming weeks, business is likely to be sluggish. In informal labour markets, daily wage labourers are not able to get enough work. Many other markets that depend on full or partial cash payment are also affected. These costs will show up in the form of lower GDP (it counts all output, with tax evasion or not) during the affected period.

- **Panic and Confusion:** This is the biggest threat. The political discourse is at the lowest. The opposition parties have been quick to fuel and magnify public annoyance over the teething problems. Misinformation and confusion is being propagated on an hourly basis to see to it that somehow this move is unsuccessful. Even majority of the TV channels, instead of being helpful or providing tips to people, are indulging in fear-mongering. OpIndia.com has busted many such rumour mongering.

The Politics:

- Some have accused the Government of taking the decision because of electoral considerations. Today in India, there is a mass hysteria about black money. The electorate has given clear signals that this is one of the issues that they care the most. It could be the real context of this calculated political gamble.
- Those backing the Government are saying this is a genuine attempt to solve a massive long overdue problem. Even those who do not support the Government agree on the scale and seriousness of the problem, while they disagree on intentions and means.
- The political capital invested in this is enormous.

The biggest hurdle in India is the lack of State capacity. But the Government and the RBI are taking steps to make life easier for people. No defining change comes without some pain. Behind the joy and hope of unification of two Germany's, lurked the pain of actually merging the two. It took the deep reserves of the famous German grit and many painful years to not just recover, but emerge as the one of the world's chief economic engine.

When an economy is suffering from cancer, the only way to deal with it is painful doses of chemotherapy. With intense follow-up and awareness campaigns, the Government can have people on its side even during their continuing hardship.

As far as I know, the decision may brighten the future of nation, but it`s total social benefit and loss cannot be calculated right now. And it is too early to produce a complete data of benefit or loss.

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B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

S.80-IA: Difference between 'manufacturing' and 'production' explained. The word 'production' has a wider connotation in comparison to 'manufacture'. Any activity which brings a commercially new product into existence constitutes production. The process of bottling of LPG renders it capable of being marketed as a domestic kitchen fuel and, thereby, makes it a viable commercial product

CIT vs. Hindustan Petroleum Corporation Ltd. [Civil Appeal No. 9295 of 2017, dated 3rd August, 2017]

The Supreme Court had to consider whether bottling of LPG, as undertaken by the assessee, is a process which amounts to 'production' or 'manufacture' for the purposes of Sections 80HH, 80-I and 80-IA of the Act?; and if so, whether the assessees are entitled to claim the benefit of deduction under the aforesaid provisions while computing their taxable income?

The Supreme Court held as under:

(i) At the outset, it needs to be emphasised that the aforesaid provisions of the Act use both the expressions, namely, 'manufacture' as well as 'production'. It also becomes clear after reading these provisions that an assessee whose process amounts to either 'manufacture' or 'production' (i.e. one of these two and not both) would become entitled to the benefits enshrined therein. It is held by this Court in Arihant Tiles and *Marbles P. Ltd. (2010) 320 ITR 79 (SC)* that the word 'production' is wider than the word 'manufacture'. The two expressions, thus, have different connotation. Significantly, Arihant Tiles judgment decides that cutting of marble blocks into marble slabs does not amount to manufacture. At the same time, it clarifies that it would be relevant for the purpose of the Central Excise Act. When it comes to interpreting section 80-IA of the Act (which was involved in the said case), the Court was categorical in pointing out that the aforesaid interpretation of 'manufacture' in the context of Central Excise Act would not apply while interpreting Section 80-IA of the Act as this provision not only covers those assessees which are involved in the process of manufacture but also those who are undertaking 'production' of the goods. Taking note of the judgment in *Commissioner of Income Tax, Goa vs. Sesa Goa Ltd. (2004) 271 ITR 331 (SC)* which was rendered in the context of section 32A of the Act and which provision also applies in respect of 'production', the Court reiterated the ratio in Sesa Goa Ltd. to hold that the word 'production' was wider than the word 'manufacture'. On that basis, finding arrived at by the Court was that though cutting of marble blocks into marble slabs did not amount to 'manufacture', if there are various stages through which marble blocks are subjected to before they become polished slabs and tiles, such activity would certainly be treated as 'production' for the purpose of section 80-IA of the Act.

(ii) Keeping the aforesaid distinction in mind, let us take note of the process of LPG bottling that is undertaken by the assessees herein and about which there is no dispute. It has come on record that specific activities at assessees' plant include receiving bulk LPG vapour from the oil refinery, unloading the LPG vapour, compression of the LPG vapour, loading of the LPG in liquefied form into bullets, followed by cylinder filling operations.

(iii) Thus, after the bottling activities at the assessees' plants, LPG is stored in cylinders in liquefied form under pressure. When the cylinder valve is opened and the gas is withdrawn from the cylinder, the pressure falls and the liquid boils to return to gaseous state. This is how LPG is made suitable for domestic use by customers who will not be able to use LPG in its vapour form as produced in the oil refinery. It, therefore, becomes apparent that the LPG obtained from the refinery undergoes a complex technical process in the assessees' plants and is clearly distinguishable from the LPG bottled in cylinders and cleared from these plants for domestic use by customers.

(iv) We may, at this juncture, refer to the judgment of this Court in *Commissioner of Income-tax, Madras v. Vinbros and Company [(2015) 14 SCC 483]* where bottling and blending of alcohol is held to be 'manufacture or production' for the purpose of section 80-IB of the Act.

S. 40(a)(ia): Sec. 194C read with sec. 200 are mandatory provisions. The disallowance stipulated in s. 40(a)(ia) for failure to deduct TDS u/s. 194C is one of the consequences for the default. Accordingly, though there is a difference between "paid" and "payable", sec. 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. The contrary interpretation that sec. 40(a)(ia) applies only to cases where amounts are "payable" will result in defaulters going scot free

Palam Gas Service vs. CIT [Civil Appeal No. 5512 of 2017, dated 3rd May, 2017] [394 ITR 300 (SC)]

The Supreme Court held as under:

(i) The question is when the word used in section 40(a)(ia) is 'payable', whether this section would cover only those contingencies where the amount is due and still payable or it would also cover the situations where the amount is already paid but no advance tax was deducted thereupon. This issue has come up for hearing before various High Courts and there are divergent views of the High Courts thereupon. In fact, most of the High Courts have taken the view that the aforesaid provision would cover even those cases where the amount stands paid. This is the view of the Madras, Calcutta and Gujarat High Courts. Contrary view is taken by the Allahabad High Court. In a recent judgment, the Punjab & Haryana High Court took note of the judgments of the aforesaid High Courts and concurred with the view taken by the Madras, Calcutta and Gujarat High Courts and showed its reluctance to follow the view taken by the Allahabad High Court.

(ii) As per section 194C, it is the statutory obligation of a person, who is making payment to the sub-contractor, to deduct tax at source at the rates specified therein. Plain language of the Section suggests that such a tax at source is to be deducted at the time of credit of such sum to the account of the contract or at the time of payment thereof, whichever is earlier. Thus, tax has to be deducted in both the contingencies, namely, when the amount is credited to the account of the contractor or when the payment is actually made. Section 200 of the Act imposes further obligation on the person deducting tax at source, to deposit the same with the Central Government or as the Board directs, within the prescribed time.

(iii) A conjoint reading of these two Sections would suggest that not only a person, who is paying to the contractor, is supposed to deduct tax at source on the said payment whether credited in the account or actual payment made, but also deposit that amount to the credit of the Central Government within the stipulated time. The time within which the payment is to be deposited with the Central Government is mentioned in Rule 30(2) of the Rules.

(iv) Once it is found that the aforesaid Sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself. Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax. While stipulating this consequence, section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to Chapter XVIIB (in the instant case sections 194C and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIB (or specifically sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences. The Punjab & Haryana High Court has exhaustively interpreted section 40(a(ia) keeping in mind different aspects.

(v) As mentioned above, the Punjab & Haryana High Court found support from the judgments of the Madras and Calcutta High Courts taking identical view and by extensively quoting from the said judgments.

(vi) Insofar as judgment of the Allahabad High Court is concerned, reading thereof would reflect that the High Court, after noticing the fact that since the amounts had already been paid, it straightaway concluded, without any discussion, that section 40(a)(ia) would apply only when the amount is 'payable' and dismissed the appeal of the Department stating that the question of law framed did not arise for consideration. No doubt, the Special Leave Petition there against was dismissed by this Court in limine. However, that would not amount to confirming the view of the Allahabad High Court (See *V.M. Salgaocar & Bros. (P) Ltd. v. Commissioner of Income Tax, (2000) 243 ITR 383* and *Supreme Court Employees Welfare Association vs. Union of India, (1989) 4 SCC 187.*

(vii) In view of the aforesaid discussion, we hold that the view taken by the High Courts of Punjab & Haryana, Madras and Calcutta is the correct view and the judgment of the Allahabad High Court in *CIT vs. Vector Shipping Services (P) Ltd., (2013) 357 ITR 642* did not decide the question of law correctly. Thus, insofar as the judgment of the Allahabad High Court is concerned, we overrule the same. Consequences of the aforesaid discussion will be to answer the question against the appellant/assessee thereby approving the view taken by the High Court.

Paras S. Savla, Jitendra Singh, Nishit Gandhi
Advocates

DIRECT TAXES
High Court

1. Penalty u/s. 221 of the Income-tax Act, 1961 – "Tax in arrears" does not include interest u/ss. 234A, 234B & 234C of the Act – Penalty levied on interest payable under section 220(2) of the Act has to be deleted

CIT vs. Orxy Finance and Investment Pvt. Ltd. [2017] 83 taxmann.com 194 (Bombay)

The learned A.O. processed the returns filed by the assessee under section 143(1) of the Act raising demand of ₹ 1,64,90,573/-. The learned A.O. has also levied penalty of ₹ 1,19,30,677/- under section 221(1) of the Act for default on part of the assessee to make payment of outstanding demand. While levying the penalty under section 221(1), the learned A.O. has included the interest component under section 234A, 234B & 234C treating the same to be part of the tax component. On appeal, the learned CIT(A) deleted the penalty holding that interest component has to be excluded while levying penalty under section 221(1) and since the penalty levied exceeded the tax component, entire penalty order was set aside. On further appeal by the Revenue, the Appellate Tribunal upheld the order passed by the learned CIT(A) in principal by observing that while levying penalty under section 221(1) of the Act interest component is not to be considered and remitted the matter to the learned A.O. with the direction to re-quantify the amount of penalty in accordance with the provisions of section 221(1) of the Act. The department further assailed the Tribunal order before the High Court. The moot question for consideration before the High Court was whether the phraseology "amount of tax in arrears" as envisaged in Section 221 of the Act would in addition to the tax include within its fold the interest component also. The Hon'ble High Court observed that the definition of the "Tax" u/s. 2(43) read in its entirety suggests that the "tax" means income-tax, super-tax and/or the fringe benefit tax, as the case may be chargeable under the provisions of the Act. The definition of tax does not take within its fold the interest component. The High Court held that, it is elementary rule of interpretation that when the language of a statute is clear and unambiguous, Courts are to interpret the same in its literal sense and not to give a meaning that would cause violence to the provisions of the statute. Each word in the statute should be assigned the meaning as per the context. Further the provision imposing penalty has to be strictly construed. The statute being fiscal and the provisions of Section 221 dealing with imposition of penalty naturally have to be strictly construed. Strict construction is a construction in which application of a provision used is limited by words used, so that anything which is not clearly included within the scope of the language is treated as excluded. Bearing this in mind, the High Court observed that on reading section 221 in its entirety, it is abundantly clear that the aspect of default in payment of tax and the amount of interest payable are treated as distinct and separate components. The section categorically and specifically states that when an assessee is in default or is deemed to be in default in making payment of tax, he shall in addition to the amount of arrears and the amount of interest payable under Sub-Section 2 of Section 220, be liable, to pay penalty, however the amount of penalty does not exceed the amount of tax in arrears. The terminology "default in making a payment of tax and amount of interest payable" are considered to be separate for imposition of penalty and penalty is to be levied on account of default in making a payment of tax. However, the total amount of penalty shall not exceed the amount of tax in arrears. The said penalty for non-payment of the tax is in addition to the levy of interest under Sub-Section 2 of Section 220. Under no principle of interpretation, the arrears of tax as laid down in the said Section would include the amount of interest payable under Sub-Section 2 of Section 220. Thus the amount of penalty will have to be restricted on the arrears of tax, which would not include the interest component charged under Section 220(2) of the Act. Reliance was placed on Hon'ble Supreme Court decision in the case of *Harshad Shantilal Mehta vs. Custodian and Others [1998] 231 ITR 871 (SC),* where the Supreme Court held that neither penalty nor interest can be considered as tax under Section 11(2)(a) of the Special Court (Trial of Offences relating to Transactions in Securities) Act, 1992.

2. Section 56(2)(iii) of the Income-tax Act, 1961 – The rental income received on leasing of building along with fixture and furniture assessed to tax as Income from Other Sources

Jay Metal Industries Pvt. Ltd. vs. CIT Income Tax Appeal No. 308 of 2016, dated 13-7-2017 (Delhi High Court)

The assessee entered into a lease deed dated 5-11-2007 with Feedback Ventures Pvt. Ltd. whereby it leased out the basement, ground plus two floors of building together with furniture and fixture for the period of four years. The rental income earned out of said lease was offered to tax as Income from House Property. The learned A.O. rejected the contention of the assessee by treating the rental income as composite rent and assessed the same as per the provisions of section 56(2)(iii) of the Act. Consequently, the deduction claimed under section 24(a) was disallowed and added to the total income of the assessee. On appeal, the learned CIT(A) observed that the assessee being owner of the building was exploiting the property by letting out the same and realizing income by way of rent. Thus, the said income was liable to be assessed under the head 'Income from house property' and the assessee is entitled for deduction under section 24(a) of the Act. The department being aggrieved by the order of the learned CIT(A) preferred an appeal before the Appellate Tribunal. The ITAT allowed the appeal of the Revenue by confirming the order of the learned A.O.

The assessee being aggrieved by the order of the ITAT preferred an appeal before the Hon'ble Delhi High Court under section 260A of the Act. The Hon'ble High Court observed that what was given on rent to the lessee was not just the building but also the fixtures and furniture which included the air-conditioning and power backup etc. There could be no doubt that the Lease Deed was a composite one and the rental receipts thereunder answered the description in section 56(2)(iii) of the Act. The Court held that letting was not merely of the building but a composite letting of both, the building as well as the equipment, furniture etc. and thereby Section 56(2)(iii) of the Act was attracted. Applying the test laid down in

Sultan Bros. (P) Limited vs. CIT [1964] 51 ITR 353 (SC) the income from the letting in the hands of the assessee was "a new kind of income" which could be considered to be income from other sources since the income not from the ownership of the building alone but an income which though arising from a building would not have arisen if the plant, machinery and furniture had not also been let along with it."

Assessee had made an alternate claim to remand the matter back to the Assessing Officer for proper determination after separate valuation of the building and the air-conditioning, furniture, fittings etc. and to tax accordingly. The High Court rejected this alternate plea on the ground that this was raised for the first time before the High Court.

However, the Court allowed the last plea that in that event the entire income from the letting is treated as 'Income from source sources', it cannot be deprived of the corresponding deduction in terms of Section 57(iii) of the Act.

3. Business expenditure – Disallowance under section 14A r.w.r. 8D – Rule 8D is not merely procedural but substantive – A.O. can resort to procedures of Rule 8D only after expressing an opinion rejecting the assessee's voluntary disallowance under section 14A r.w.r. 8D. A.Y. 2006-07

Pr. CIT vs. U.K. Paints India (P) Ltd. [2017] 153 DTR 201 (Del.)

The assessee, a private limited company, declared exempt income of ₹ 25 crores. It disallowed a sum of ₹ 7.5 lakhs under section 14A towards the exempt income. The A.O. did not accept the voluntary disallowance made by the assessee and re-computed the disallowance under section 14A r.w.r. 8D at ₹ 2,55,02,142/-. The CIT(A) upheld the action of the A.O. The Appellate Tribunal allowed the appeal of the assessee relying on the decision of Hon'ble Delhi High Court in the case of *CIT vs. Taikisha Engineering India Ltd. [2015] 370 ITR 338 (Delhi)* to the effect that the AO can proceed to make an independent determination of the disallowance under Rule 8D read with Section 14(2) after recording his satisfaction about the amount and the reasons thereof proffered by the assessee voluntarily under Section 14A. The department preferred an appeal before the Hon'ble Delhi High Court. The High Court observed that section 14A is in a sense a taxing exception to the stream of income which is otherwise exempt, i.e. tax exempt income. The principle of disallowance is stated in Section 14A(1). Section 14A(2) prescribes the mode or methodology for the disallowance and the steps for its calculation. Unlike the other part of the statute which decree or enjoin the actual methodology and are substantive, Parliament deemed it appropriate to leave it to the rule making authority to prescribe the methodology, i.e. computation. For instance, what are taxable and in what proportion and the principles applicable are embedded in the statute in certain provisions, such as Sections 28 to 43 and Sections 80A to 80HHC when it comes to deductions. Instead of adopting that mode, the Parliament thought it appropriate to leave the mode to the rule making authority. In that sense, the rules are not merely procedural but are substantive and can be said to be engrafted in the statute, as is evident from the mandate of the first part of Section 14A(2). That apart, significantly, the question of applying the statutorily prescribed method would arise only and only if the AO expresses an opinion rejecting the assessee's methodology and the figure offered at the time of assessment. This is material because the jurisdiction to go into the method prescribed in the Rules arise only if the amounts the assessee offers does not have any realistic correlation with the tax exempt income. The opinion of the Assessing Officer in the latter part of Section 14A(2) is to be based upon an appraisal of objective material relating to the assessee's voluntary disallowance of amount/amounts. Not only that, if in the course of assessment, the AO enquires from the assessee about the amounts spent, which are to be disallowed, and the assessee in fact discloses a larger amount (than the one given in the return), it is still incumbent upon the AO to enquire into such larger amounts and determine whether it has nexus with expenditure relatable to exempt income to attract Section 14A(1). Sans this procedure, Section 14A would be reduced to a mere formality which it appears to have become in the circumstances of the case. Thus Hon'ble court dismissed the departmental appeal by observing that A.O. cannot re-compute disallowance under section 14A by invoking rule 8D without elucidating and explaining why assessee's voluntary disallowance is unreasonable and unsatisfactory.

4. Section 253 – Power to condone of delay while filing an appeal before the Tribunal

United Christmas Celebration Committee Charitable Trust vs. ITO – [Tax Case Appeal. 886 of 2016, Madras High Court]

The appeal filed by the assessee before the Hon'ble Tribunal was delayed by 1631 days. The reason for delay as explained by the Assessee was that its Chartered Accountant was unaware of the provisions of the Income-tax Act and therefore did not advise it to file an appeal. Further No affidavit was also filed either by the assessee or its Chartered Accountant in support of the petition seeking condonation of delay before the Tribunal. The High Court was posed with a question that, can a litigant be prejudiced on account of, virtually, ignorance of law displayed, by a professional engaged by him, to prosecute his case before the appropriate forum. Reliance was placed on Supreme Court decision in case of *Motilal Padampat Sugar Mills vs. State of U.P. AIR 1979 SC 621* – wherein, it accepted the dicta of Maule, J. and Lord Atkin, that while ignorance of law is no excuse, (a maxim of different scope and application), there is not and never has been a presumption that everyone knows the law. In the said case the court observed as under at page 629 :

> *'……. 6. The claim of the appellant to exemption could be sustained only on the doctrine of promissory estoppel and this doctrine could not be said to be so well defined in its scope and ambit and so free from uncertainty in its application that we should be compelled to hold that the appellant must have had knowledge of its right to exemption on the basis of promissory estoppel at the time when it addressed the letter dated 25th June, 1970. In fact, in the petition as originally filed, the right to claim total exemption from sales tax was not based on the plea of promissory estoppel which was introduced only by way of amendment. Moreover, it must be remembered that there is no presumption that every person knows the law. It is often said that every one is presumed to know the law, but that is not a correct statement: there is no such maxim known to the law. Over a hundred and thirty years ago, Maule, J., pointed out in Martindala vs. Faulkner, (1846) 2 CB 706 "There is no presumption in this country that every person knows the law: it would be contrary to common sense and reason if it were so". Scrutton, also once said: It is impossible to know all the statutory law, and not very possible to know all the common law."*

But it was Lord Atkin who, as in so many other spheres, put the point in its proper context when he said in *Evans vs. Bartlem, 1937 AC 473* " ….. the fact is that there is not and never has been a presumption that every one knows the law. There is the rule that ignorance of the law does not excuse, a maxim of very different scope and application." It is, therefore, not possible to presume, in the absence of any material placed before the Court, that the appellant had full knowledge of its right to exemption so as to warrant an inference that the appellant waived such right by addressing the letter dated 25th June, 1970. We accordingly reject the plea of waiver raised on behalf of the State Government. ....'

The Court further observed that there is another aspect of the matter, which is that, in dealing with issues, such as the one, the court was faced with, not only the period of delay has to be taken in account, but also the quality of explanation, the legal assistance, if any, sought and rendered to the litigant, and the detriment that condonation of delay would cause to the opposing party. These are aspects, if, looked at, closely, will enable the Court to come to a conclusion as to whether the delay was intentional and/or deliberate. The Court held that from the record that the assessee, perhaps, did not receive the best legal assistance in the matter. Therefore, notwithstanding the fact that the period of delay is large, the Court condoned the delay in filing the appeal and directed the Tribunal to hear the appeal afresh on merits.

5. Section 253 – Cross objections filed before the Tribunal after the High Court set aside earlier order

Ashian Needles Pvt. Ltd. vs. CIT – [ITA No. 331 to 334 /2012, Delhi High Court]

The Income Tax authorities made re-assessments on the assessee on 28-12-2007. In the appeal the assessee objected to the assumption of jurisdiction under Section-147 by the A.O. and also objected to the addition of certain amounts on merits. The Commissioner (Appeals) by order dated 30-4-2009 upheld the order on jurisdiction even while accepting the assessee's appeal on merits. The Department carried the matter in appeal to the ITAT. The assessee did not file any appeal. The ITAT decided the appeals by its order stating therein that none appeared at the time of hearing on behalf of the assessee in spite of service of notice of hearing. The Tribunal by that order directed remand to the A.O. on the question of consideration of additional evidence relied upon by the appellant. The matter was carried in appeal by the assessee to the High Court under Section 260A. The Appellant had stated that no notice of hearing before the Tribunal was served on it. The Hon'ble High Court disposed of the said appeals. The Court however, expressly kept open and did not go into the question whether notice of appeals before the ITAT had in fact been served upon the assessee. The Hon'ble High Court in its order dated 13-7-2010 merely directed the Tribunal to adjudicate the matter afresh on the applicability of Rule 46(A) and whether in obtaining the factual matrix, the only option was to remand the matter to the Assessing Officer. Again, after the said order, on 18-3-2011 the appellant filed its cross-objection before the ITAT under Section 253(4) of the Act challenging the jurisdiction to make an assessment u/s. 147/148 of the Act. It was contended that the ITAT had not issued notice and that the appellant became aware of the pendency of the remitted appeals only upon noticing them in the cause list. The Revenue objected to the cross-objection. The Tribunal again in its order dated 21-10-2011 dismissed the cross objections stating therein, that validity or otherwise of re-assessment proceedings was never a question before the Tribunal. It also held that by filing the cross objections after the decision of Hon'ble High Court, the assessee intended to act against the well settled proposition of law according to which what cannot be done "per directum" is not permissible to be done "per obliquum" meaning thereby whatever is prohibited by law to be done, cannot legally be effected by an indirect or circuitous contrivance on the principle of *"quando aliquid prohibetur, prohibetur at omne per quod devenitur ad illud"*. Applying the above principle, it was held that relief sought by the assessee through cross objection cannot be given in law. It was further held that the relevant date of receipt of notice of appeal will be in respect of original hearing when the appeals of revenue were decided by the Tribunal *vide* order dated 6th November, 2009. Fixing of appeal in pursuance of directions of Hon'ble High Court does not give right to the assessee to file cross objections as this right is available only when the appeal is fixed for hearing by the Tribunal of the other party in respect of an appeal filed before the Tribunal. Against the said order the assessee again filed an appeal before the Tribunal. The Hon'ble High Court allowed assessee's appeal observing that, the Tribunal could not have rejected the cross objections without entering into the factual matrix and being satisfied itself that the appellant had not in fact filed cross-objections at the time when it could have originally when the appeals had been filed before the ITAT. This was evident from a reading of this Court's order in ITA Nos. 876, 877, 878 and 880/2010 particularly where the issue of whether notice was issued was left open. Furthermore, the impugned order itself appears to have proceeded on the assumption that the assessee did not choose to file cross-objections despite service of notice. The assessee's argument was that notice in fact was not served even after remand from this Court and that the cross-objection was filed since the pendency of appeals was noticed. The Court held that the Tribunal could have examined whether the cross objections could be entertained in the facts and circumstances of the case having regard to the independent power to entertain them contained under Section-253 (5) of the Act. Thus the Tribunal order was set aside. Court directed that the cross-objections of the assessee shall be considered, and it is open to the Tribunal to examine whether there was any delay in filing of the appeal and if so, whether the same can be condoned. The cross-objections shall be considered after giving due notice to the parties and permitting the appellant to raise such contentions including filing such affidavits as regards the issue of delay as may be necessary in the circumstances of the case.

6. Penalty u/s. 271(1)(c) – Addition u/s. 68

CIT vs. Dhanji Gala – [Income Tax Appeal No. 198 of 2015, Bombay High Court]

Assessing Officer made an addition u/s. 68 in the hands of the assessee in respect of certain loans taken by treating them as unexplained loans by the AO. The lenders had denied giving any loans to the assessee and also that they did not have the capacity to grant such loans, in their statement before the AO. The assessee accepted the said addition and did not challenge the same in appeal. On this addition the AO levied penalty u/s. 271 (1) (c) of the Act on the ground that the assessee has concealed particulars of income and also furnished inaccurate particulars. The said penalty was challenged before the CIT(A) who confirmed the same. On further Appeal the Tribunal reversed the orders of the lower authorities and deleted the penalty levied on unexplained loans. The Tribunal held that there was lack of enquiry on the part of the AO and hence the penalty could not be sustained. The Department filed further appeal to the Hon'ble High Court which was dismissed observing that the assessee furnished reasons as to why he has accepted the assessment of loan amount as his income. The Tribunal observed that the assessee has received the loan by account payee cheque through broker and has also repaid the loan through account payee cheque, which is spelt out from the record. The Assessing Officer did not inquire about the bank account maintained by the lender and the loan transactions carried out through account payee cheques and also about the income tax returns filed by her. If the AO had conducted inquiry about the same, further truth might have come on the fore. The reasoning adopted by the Tribunal is plausible one. Considering the aforesaid reasoning, there is no reason to entertain the appeals challenging the order of setting aside the penalty.

Neelam Jadhav, Keerthiga Sharma &
Neha Paranjpe, *Advocates*

DIGEST OF CASE LAWS
Tribunal

Reported Decisions

1. Penalty – Section 271AAA – No question asked in the statement recorded under section 132(4) of the Act pertaining to the manner of earning the income declared – Department later cannot plead deficiency on part of the assessee – Penalty is to be deleted

CIT vs. Shreenarayan Sitaram Mundra [2017] 83 taxmann.com 231 (Ahmedabad – Trib.) [Assessment Year: 2010-11]

Facts

The assessee is engaged in the business of manufacturing and trading of textiles. A search action was carried in the assessee's premises under section 132 of the Act. During the course of search the assessee disclosed an unaccounted income of ₹ 2 crores and filed a return in pursuant to the notice under section 153A of the Act. The assessment was completed at same figure declared by the assessee in his return. The Ld. A.O. imposed the penalty of ₹ 20 lakhs under section 271AAA of the Act on the ground that the assessee has not specified the manner in which income declared was earned. On appeal, the Ld. CIT(A) deleted the penalty levied by the Ld. AO observing that the assessee has fallen under the exception provided under section 271AAA of the Act. The department being aggrieved by the appellate order preferred the appeal before the Appellate Tribunal.

Held

The Appellate Tribunal dismissed departmental appeal by observing that as per section 271AAA(2)(i), one of the conditions for obtaining relief the imposition of penalty under section 271AAA is that the assessee in the statement recorded under section 132(4) admits the undisclosed income and specified the manner in which such income has been derived. Section 271AAA(2)(ii) casts obligation on the part of the assessee to 'substantiate the manner' in which the undisclosed income was derived. Admittedly the Revenue is not aggrieved by the condition under sub-section 2(ii). Further, the Revenue admits that the assessee has not failed to substantiate the manner in which the undisclosed income has been derived. The revenue does not appear to have quizzed the assessee for satisfying the manner in which the purported undisclosed income has been derived. The income considered as an undisclosed income in the statement under section 132(4) has been duly incorporated in the return filed pursuant to search. Thus, the revenue now cannot plead deficiency on the part of the assessee to specify the manner which has not been called into question at the time of search. Nowhere in the assessment order or in the penalty order, the revenue has made out a case that the manner of earning undisclosed income was enquired into post search stage either. The revenue has not pointed out any query which was remained to be replied. Thus, we hereby confirmed the order of the Ld. CIT(A).

2. Transfer Pricing – Section 92 and 144C – Final Assessment Order passed beyond the time limit prescribed would not be null and void

Himalyan Drug Co. vs. DCIT (ITA No. 807/ Bang/2016) (TS-566-ITAT-2017(Bang.)-TP) [Assessment Year: 2011-12]

Facts

During the course of assessment, an adjustment relating transfer pricing was made to the income of the assessee. The Transfer Pricing Officer ('TPO') had passed the order u/s. 92CA of the Act on 30 January, 2015 and the draft assessment order was passed by the AO on 31st March, 2015. The DRP gave its directions on 17th December, 2015, which was received by the AO on 29th December, 2015. The final assessment order was passed on 18th February, 2016. The assessee contended before the ITAT that the final assessment order was passed beyond the prescribed time limit and was in contravention of section 144C(13) of the Act.

Held

The ITAT held that the proceedings could not be declared as null and void simply because the AO had passed the final assessment order beyond the time limit prescribed in the Act. It held that as per the provisions of section 144C(13) of the Act, the AO had no discretion, but he had to follow the directions of the DRP and even an opportunity was not granted to the Aassessee before passing the same. Hence, there was no prejudice caused to the assessee due to the delay in passing of final order. Further, the ITAT observed that section 144C did not expressly prohibit the AO from passing the order beyond the period prescribed therein and consequently, the final assessment order was not barred by limitation.

3. Transfer Pricing – Section 92 – Locations Savings Adjustment cannot be based on mere presumptions. Matter remanded since TPO had neither looked into the comparability of comparable companies selected by the assessee nor had he taken any steps to find out other comparable companies for determination of ALP

Parexel International Clinical Research Pvt. Ltd. vs. Dy. CIT (ITA No. 254/Bang/2016 & 292/Bang/2017) (TS-580-ITAT-2017(Bang)-TP) [Assessment Year: 2011-12 & 2012-13]

Facts

The assessee provided clinical research services to its associated enterprises ('AE'). To benchmark its international transactions the assessee selected Transactional Net Margin Method ('TNMM') and it submitted that since its margin was higher than that of comparable companies, its international transactions were at arm's length. The TPO alleged that conducting clinical trials in India had resulted in location savings to the AE since regulatory, compliance and investigatory costs were significantly lower in India. The TPO used Profit Split Method ('PSM') and allocated location savings equally between the assessee and its AE. The Dispute Resolution Panel ('DRP') upheld the order of the AO / TPO.

Held

The ITAT deleted the transfer pricing adjustment and held that location savings were available to all parties irrespective of whether the transaction was with a related or unrelated party. Hence, if comparable uncontrolled price was available, the location savings could not be the basis for determination of arm's length price. Following the orders of the ITAT in the case of *Watson Pharma Pvt. Ltd. vs. DCIT (ITA No. 1423/Mum/2014)* and *Syngenta India Ltd. vs. DCIT (ITA No. 1373/ Mum/2014),* it was held that the order of the TPO was based on presumption inferred from articles and not based on actual data. However, the ITAT remanded the matter to the TPO since he had neither examined the functional comparability of the companies selected by the assessee nor had he found out other companies to determine the arm's length price of the international transaction.

Unreported Decisions

4. Assessment of any other person – Search and Seizure – Section 153C – addition made beyond seized material is unjustified

ACIT vs. New India City Developers Ltd [ITA No.: 3639/Del/2014] Dt. 10-4-2017 (Assessment Year – 2005-06)

Facts

Assessee is a Company engaged in the business of real estate. A search and seizure action was carried out in the business premises of Today Group, related to the assessee on 26-11-2009. During the course of the search proceedings certain documents pertaining to the assessee company were found and seized. On the basis of the said material satisfaction note was drawn by the Ld. AO to initiate the proceedings under section 153C of the Act. Further, the assessment was completed under section 143(3) r.w.s 153C of the Act by making addition of ₹ 15 lakhs as advance received from Savsudha, disallowance of ₹ 7,98,348/- on account of excess depreciation claimed and ₹ 48,27,364/- out of travelling and conveyance expenses. On appeal, the Ld. CIT(A) allowed the appeal and deleted addition and disallowance made by the Ld. AO. The department being aggrieved by the appellate order preferred the appeal before the Appellate Tribunal.

Held

The Hon'ble Tribunal dismissed departmental appeal by observing that the assessment for the present case was not pending at the time of search. Further, looking at the satisfaction note we do not find any material pertaining to the additions made by the Ld. A.O. as well as no such material was put to our attention by the Ld. AO on the impugned additions. Therefore, we do not find any infirmity in the order of the Ld. CIT(A) in holding that there is no incriminating material unearthed during the course of search which related to the addition and then deleting the addition. Therefore, the appeal of the revenue is dismissed. The Appellate Tribunal relied on the decision of Hon'ble Delhi High Court in the case of *CIT vs. Kabul Chawla 380 ITR 573 (Del.)*

5. Business Expenditure – Section 37(1) – Purchase of sales tax exemption certificates is revenue expenditure [Reliance Industries Ltd. 88 ITD 273 Mumbai Special Bench Distinguished]

Dy. CIT vs. Orient Paper & Industries Ltd. (ITA Nos.1936/Kol/2014) dt. 9-6-2017 [Assessment Year 2006-07]

Facts

The assessee Company was engaged in manufacturing of papers, cement, fans and other engineering products. The original assessment was completed u/s.1 43(3). After that CIT exercised his jurisdiction u/s. 263 declared that the assessment was erroneous and prejudicial to the interest of revenue therefore he directed the AO to examine the issue of allowability of sum claimed towards purchase of sales tax exemption certificates.

During the second round of assessment proceedings, assessee produced evidence to support its claimed and submitted that the sales tax exemption certificates were purchased from the three different Wind Power Projects for a consideration. As per the Sales Tax Sheme 1998 introduced by the Government of Maharashtra the assessee claimed credit of sales tax payments by way of purchase of sales tax exemption certificates. But the AO held that said amount was not credited to P&L account, and the assessee has debited the amount for purchase of the sales tax exemption certificates to its P&L account as against sales tax exemption availed. Further AO relied on Special Bench decision *Reliance Industries Ltd. 88 ITD 273 (Mum)(Trib.)(SB)* and treated purchase of exemption certificates as capital expenditure and added to the total income. The CIT(A) contradicted the decision of the AO stating that Special Bench was entirely different and therefore he deleted the addition made by the AO.

Held

The assessee claimed expenditure from purchasing certificates from third party under the scheme introduced by the Government of Maharashtra and with the permission of the concerned department and said certificates are not subsidy from sales tax department. Therefore, purchase of sales tax exemption cannot be treated as capital expenditure of the assessee Company.

6. Capital Gains – Section 48 – Sale of agricultural land – Levy of capital gains tax is unjustified

M. R. Diwakar vs. ACIT (ITA No. 1406/Chny/2016) dt. 27-4-2017 [Assessment Year: 2011- 12]

Facts

The assessee was an individual earning income under the head salary, house property, business and other sources, filed his return of income for the assessment year 2011-12. The case was selected for scrutiny and order u/s. 143(3) was passed. While completing the assessment the AO treated the agricultural land sold by the assessee as non-agricultural and stating that the same was fall under the ambit of capital gains tax. Therefore he taxed under the capital gains. The CIT(A) confirmed the order of the AO.

Held

The ITAT held that the land sold by the assessee was adjacent to the land sold by other party which was also an agricultural land. As far as land is concerned assessee's land falls outside the scope of "capital asset" by virtue of S. 2(14) therefore capital gains tax will not be attracted to the assessee. When the adjacent land was agricultural in nature then land sold by assessee cannot be treated as capital asset in the hands of assessee, therefore it was exempted from capital gains tax.

7. Exemption – section 54F r.w.s 161 of the Act – Trust is entitled for deduction under the capacity of an individual

Balgopal Trust vs. ACIT 18(1) [ITA No.: 5661/Mum/2016] Dt. 3-5-2017 (Assessment Year – 2012-13)

Facts

The assessee is a Private Non-Discretionary Trust. During the relevant assessment year assessee sold 1,000 unquoted equity shares of M/s. Somani & Company Pvt. Ltd. to Satguru Corporate services Pvt. Ltd. (SCSPL) at ₹ 91,000/- each. The SCSPL agreed to give further consideration of ₹ 8,16,49,219/- to the assessee by way of flat valued at ₹ 15,63,98,521/-. Thus, the difference of ₹ 7,46,59,302/- to be paid by the assessee to SCSPL was kept in the capital gains fixed deposits. The total consideration received by the assessee is ₹ 17,26,49,219/- and the total cost of the flat was arrived at ₹ 16,50,00,000/-. Thus, the assessee claimed exemption under section 54F for ₹ 16,50,00,000/-. The Ld. A.O. denied the claim of deduction by observing that the deduction under section 54F is allowable only to the individual or HUF and not to any other person. On appeal, the Ld.CIT(A) confirmed the disallowance made by the Ld. A.O. The assessee being aggrieved by the appellate order preferred the appeal before the Appellate Tribunal.

Held

The Appellate Tribunal in its order observed that by virtue of section 161 of the Act the representative assessee is subject to the same duties, responsibilities and liabilities as if the income was received by him beneficiary, and whatever benefits the beneficiary will get in the said assessment must be made available to the trustee which assessing him under section 161 of the Act. Thus, we hold that the assessee is preliminary entitled to deduction under section 54F of the Act.

8. Penalty – Section 271B – Failure to get accounts audited – No penalty levied for reasonable cause of not getting accounts audited u/s. 44AB within prescribed time

A. P. Dairy Development Co-operative Federation Ltd. & Anr. vs. Dy.CIT (ITA Nos. 741, 742 and 744/ Hyd/2015) dt. 2-6-2017 [Assessment Year 2004 -05, 2005- 06 and 2011-12]

Facts

The assessee company was engaged in the business of processing and sale of milk and milk products. During the assessment proceedings AO observed that the assessee company mainly engaged in the activities of procurement of milk from farmers, process the same into whole milk, standardized milk, toned milk and milk products and sells them. The AO observed that the assessee has filed its return of income on the basis of provisional accounts for the financial year 2004-05 and enclosed the annual report in form No. 3CA. He observed that as per the provisions of Andhra Pradesh Co-operative Societies Act, 1964, auditors for the assessee have to be appointed by the Addl. Registrar/Chief Auditor, Office of the Registrar of Co-Op. Societies, Hyderabad and the appointed auditors have to conduct audit for the A.Y. 2003-04. Since the assessee has not filed the audited report along with the return of income. The AO held that in the absence of audited books of account, it is not possible to verify the veracity and authenticity of the quantum of expenditure claimed. He levied penalty u/s. 271D for non-filing of audit report. The CIT(A) confirms the order of the AO.

Held

The ITAT held that, the assessee has filed its return of income on the basis of provisional accounts and the AO has rejected the books which were not reliable. As a Government agency the assessee company had no power to appoint the auditors by itself. The assessee company abides by rules framed under Societies Act and therefore, the situation was beyond control of assessee and was prevented by reasonable cause for not getting its accounts audited u/s. 44AB within prescribed time therefore penalty cannot be levied under section 271D.

9. Penalty – Section 271(1)(c) – Failure of non-resident entity to file return of income voluntarily and offer its income to tax could not lead to penalty, since it was under the *bona fide* belief that its income was not taxable as per the India-UK DTAA

Dy. DIT vs. Metapath Software International Ltd. (ITA No. 1393/Del/2011) [Assessment Year: 1997-98]

Facts

The assessee was a non-resident and earned income from supply of network equipment (hardware and software) to Indian customers. Taking recourse to Article 7 of the India-UK Double Taxation Avoidance Agreement ('DTAA'), the assessee submitted that since it did not have a permanent establishment in India, its business profits from India were not taxable in India. The Assessing Officer ('AO') alleged that the profit from supply of hardware arose out of India and was taxable at the rate of 40%, while the income from supply of software was taxable as royalty at the rate of 30% on gross basis. The Commissioner of Income-tax (Appeals) ('CIT(A)') gave part relief to the assessee, which was upheld by the Income tax Appellate Tribunal ('ITAT'). On further appeal by the department, the High Court of Delhi dismissed the appeal of the Revenue. The AO had levied penalty u/s. 271(1)(c) of the Act, which was deleted by the CIT(A). The Revenue was now in appeal before the ITAT.

Held

The ITAT held that the assessee was under a *bona fide* belief that its profits were not taxable in India based on the relevant provisions of the India-UK DTAA. The issue was debatable and failure to voluntarily file return of income under a *bona fide* belief could not be construed to be concealment of income or furnishing incorrect particulars of income. Further, the CIT(A) and the ITAT had partially upheld the taxability of the assessee in India and hence it could not be inferred that the Assessee had filed incorrect particulars of income. Accordingly, the ITAT deleted the levy of penalty u/s. 271(1)(c) of the Act.

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. SUPREME COURT

1. The Apex Court dismissed revenue's SLP against High Court's order deleting penalty levied u/s. 271(1)(c) where the assessee had computed ALP as per the provisions of section 92C in good faith and with due diligence

Mitsui Prime Advanced Composites India Pvt. Ltd. [TS-599-SC-2017-TP]

Facts

i) The assessee entered into international transactions of availing specified business and consultancy services, engineering support services and management support services with three different AEs and adopted TNMM as the most appropriate method.

ii) The TPO contended that the assessee had failed to give any evidence as to the benefit accruing to it by the receipt of these services and accordingly, adopting CUP as the most appropriate method, he determined ALP of these transactions at NIL and made a TP adjustment. The assessee did not challenge the TP additions since the returned loss was marginally reduced after TP additions. Thereafter, the AO imposed penalty u/s. 271(1)(c) for concealment of income/furnishing of inaccurate particulars.

iii) The CIT(A) upheld the penalty imposed by the AO.

iv) The Tribunal observed that the assessee had applied TNMM as per the provisions of section 92C which was rejected by TPO applying CUP method without any justification. Further, it observed that the assessee pursuant to the business consultancy agreement had undertaken manufacturing activity, had availed engineering services for installing plant and machinery and had availed management services for market development in India. Accordingly, it rejected the contention of the AO that the ALP of the services was Nil since the assessee had not availed any services and held that the assessee had demonstrated availing of the services. Accordingly, it held that the penalty imposed by the AO by invoking Explanation 7 to section 271(1)(c) was not justified since the assessee had proved that the price paid by it under such transactions was computed in accordance with the provisions of section 92C and in the manner prescribed under the TNMM in good faith and with due diligence. Accordingly, it held that there was no concealment of income or furnishing of inaccurate particulars for attracting penalty u/s. 271(1)(c).

v) The High Court upheld the Tribunal's order and rejected the revenue contention that assessee's failure to substantiate benefit derived from services resulted not only in rejection of TNMM but also reduction in losses which warranted application of Explanation 7 to Section 271(1)(c).

vi) Aggrieved, the revenue filed SLP before Apex Court.

Held

i) The Apex Court dismissed the Revenue's SLP – thereby affirming the High Court's judgment deleting concealment penalty levied u/s. 271(1)(c).

2. The Apex Court dismissed Revenue's SLP against High Court order deleting TP – adjustment on interest on receivables from AE

Bechtel India Pvt. Ltd. [TS-591-SC-2017-TP]

Facts

i) The assessee, a captive service provider had entered into international transactions pertaining to provision of support services to its AEs. There was delay in realisation of payment from AEs against the sales made for which the assessee did not charge interest. The assessee did not earn any interest on any advances given to third parties as well.

ii) During the course of assessment proceedings, the TPO treated the delayed payments as loan facility advanced to the AE's and charged 14.88% interest for delayed period beyond 30 days.

iii) DRP upheld the TP adjustment.

iv) The Tribunal observed that the assessee was a captive service provider and was a debt free company. Further, it observed that the revenue had also not brought on record that the assessee had paid any interest to its creditors or suppliers on delayed payments. Accordingly, it held that question of receiving any interest on receivables did not arise. Relying on co-ordinate bench ruling in Kusum Healthcare Pvt. Ltd., wherein no adjustment for receivables was made since the assessee had factored impact of receivables on working capital, it directed that no separate adjustment for interest on receivables was warranted in the hands of the assessee.

v) The High Court upheld the order of the Tribunal.

vi) Aggrieved, the Revenue filed SLP before the Apex Court.

Held

i) The Apex Court dismissed Revenue's SLP upholding the order of the High Court.

B. HIGH COURT

3. The Court held that an enterprise shall not be an AE merely on the basis of participation in the management or control or capital of another enterprise unless criteria specified u/s. 92A(2) was also satisfied

Veer Gems [TS-545-HC-2017(GUJ)-TP]

Facts

i) The assessee, a partnership firm engaged in the business of manufacture and sale, domestic as well as exports, of the polished diamonds had imported rough diamonds from M/s. Blue Gems BVBA (a Belgian entity).

ii) The AO observed that 3 brothers along with their families were partners of the assessee firm and the fourth brother along with his family controlled M/s. Blue Gems BVBA. Accordingly, he contended that since both the entities were controlled by same family of 4 brothers and their close relatives, M/s. Blue Gems BVBA was an AE of the assessee as per section 92A(2)(j). Therefore, he made TP adjustment.

iii) The CIT(A) without deciding whether the two entities were AE held that the transfer prices were at ALP and accordingly, deleted the TP addition made by the AO. He further held that since the TP addition was deleted, the issue of whether the two entities were AEs was academic.

iv) The Tribunal noted that Memorandum to Finance Bill, 2002 stated that mere participation by one enterprise in the management or control or capital of the other enterprise shall not make them AEs unless the criteria specified in section 92A(2) were fulfilled. It further observed that AO had erroneously invoked section 92A(2)(j) since that clause provided for control of an enterprise by an individual and since the assessee was a partnership firm, it could not have been said that the assessee was controlled by an individual. Accordingly, it held that since none of the criteria u/s. 92A(2) were fulfilled by both the entities, the assessee and Blue Gems BVBA were not AEs and the TP adjustment was not warranted.

v) Aggrieved, the Revenue appealed before the High Court.

Held

i) The Court concurred with the findings of the Tribunal that section 92A(2)(j) would apply in case of an enterprise controlled by an individual. Accordingly, it held that since both the enterprises were partnership firms it could not have been said that they were controlled by individuals and therefore, clause (j) of section 92A(2) would not apply.

ii) It further examined the provisions of section 92A(2)(i) and (l) and held that section 92A(2)(i) would apply in case where goods or articles were manufactured or transferred by one enterprise to the other. It held that since M/s. Blue Gems was neither a manufacturer nor did it process any articles, the said clause would not apply.

iii) It further observed that clause (l) of section 92A(2) applies to partnership firms where one enterprise holds not less than 10% in the other enterprise. It held that the said clause would not apply to the facts of the assessee.

iv) Accordingly, it upheld the order of the Tribunal holding that M/s. Blue Gems and the assessee were not AEs as the condition u/s. 92A(2) were not satisfied.

4. Where the assessee had benchmarked interest received on foreign currency loan given to its AE with the interest paid by it on its own borrowings of loan in foreign currency, the Court held that the transaction was at arm's length not warranting TP adjustment

The Great Eastern Shipping Co. Ltd. [TS-534-HC-2017 (BOM)-TP]

Facts

i) The assessee had provided foreign currency term loan of USD 4 million to its subsidiary towards working capital requirement and a foreign currency term loan of USD 17 million to another subsidiary for a new building rig contract. The assessee had charged interest @ 5% p.a. on loan of USD 4 million which was based on the two years USD fixed IRS rate + 100 BPS and 7.3% p.a. on second loan of USD 17 million. The assessee had also obtained a USD loan from Export Import Bank of Korea (KEXIM) @ 4.79% p.a. Adopting the CUP method, it compared the rate of interest charged by it on the loans given to its AE with the rate of interest charged by the KEXIM and claimed the transactions to be at ALP.

ii) The TPO considered the interest rate prevalent in India @ 14% p.a. for benchmarking loan transactions and made the TP adjustment.

iii) The CIT(A) held that the TPO's adoption of 14% rate was without any basis and that LIBOR should have been adopted for benchmarking for foreign currency loans. Further, it rejected the assessee's contention of adopting 2-year USD IRS rate plus 100 BPS or ceiling rate prescribed by the RBI for export credit on the ground that 2-year USD IRS rate was for conversion of floating rate of interest to the fixed rate of interest and export credit rates were in respect of export consignments and not for the purpose of working capital. Relying on the RBI's Master Circular No. 07/2006-07 dated July 1, 2006 on ECB, for loan of USD 4 million, it adopted 6 months LIBOR + 200 BPS (for loans with maturity period of 3 – 5 years) and for loan of USD 17 million, it adopted 6 months LIBOR + 350 BPS (applicable to loans with maturity period more than 5 years).

iv) In respect of loan of USD 4 million, the Tribunal observed that the CIT(A) completely ignored the fact that the loan was given by the assessee to its AE in the earlier years and the benchmarking was done by the assessee by applying rate of interest of 5% as per the prevailing rate in that earlier year and no TP adjustment was done in that year. It held that this year the assessee had charged interest only on the loan brought forward from the earlier year and the fixed rate of interest could not be changed with the subsequent change in LIBOR. It further observed that for loan of USD 17 million although the loan was given for long term but it was repaid within the year itself. Accordingly, it held that the CIT(A) erred in applying rate for more than 5 years at 6 months LIBOR plus 350 basis points. It deleted the TP addition holding that the benchmarking done by the assessee was based on the interest paid by it on its own borrowings of loan in foreign currency from KEXIM bank and accordingly, the interest charged by the assessee on the loan given by it to its AE was at ALP.

v) Aggrieved Revenue appealed before the High Court.

Held

i) The Court relied on the Bombay High Court's decision in *CIT vs. Tata Autocomp [TS-45-HC-2015(Bom)-TP]* wherein it was held that ALP in the case of loans advanced to AEs was to be determined on the basis of rate of interest being charged in the country where the loan was received/consumed.

ii) It observed that the Revenue had not brought on record any evidence to prove that the rate of interest charged by the assessee was different than the interest rate in the country where the loan was received by AE. It held that the period of loan was to be considered and not the period of repayment. However, considering that the assessee had obtained loan at 4.79% and had advanced loan to its AE at 7.3%, it held that the Tribunal had correctly dealt with the same.

iii) Accordingly, it upheld the order of Tribunal deleting the TP adjustment.

5. The Court held that Tribunal had power to extend interim order of stay beyond 365 days in deserving cases

Pepsi Foods Pvt Ltd. [TS-558-HC-2017(DEL)-TP]

Facts

i) The assessee was granted initial stay by the Tribunal for a period of 365 days. But the period of 365 days from the grant of initial stay had elapsed. Since the delay was not attributable to the assessee, the Tribunal granted further stay.

ii) The Revenue filed an appeal before the High Court contending that as per the provisions of section 254(2A) the Tribunal was not empowered to grant further extension of stay beyond period of 365 days even though the delay was not on account of any conduct attributable to the assessee.

Held

i) The Court held that the issue of the power of the Tribunal to extend the interim order of stay beyond 365 days in deserving cases, was covered against the Revenue by the decision of this Court in the case of *Pepsi Foods Pvt. Ltd. vs. ACIT [W.P. (C) No. 1334 of 2015]* wherein it was held that where the delay in disposing of the appeal was not attributable to the assessee, the Tribunal had power to grant extension of stay beyond 365 days in deserving cases.

ii) Accordingly, it dismissed the appeal of the revenue.

6. The Court dismissed the revenue's appeal against Tribunal's order deleting the TP adjustment since as per the proviso to Section 92C(2), the transfer price was within the range of 5% of ALP

DHL Danzas Lemuir Pvt. Ltd. [TS-559-HC-2017(Bom)-TP]

Facts

i) The TPO had made TP adjustment in the case of the assessee which was upheld by the DRP.

ii) The Tribunal however, deleted the TP adjustment made by the AO since as per the proviso to Section 92C(2), the transfer price was within the range of 5% of ALP and accordingly, it directed the AO to consider proviso to Section 92C(2) and arrive at conclusion.

iii) Aggrieved, the Revenue appealed before the High Court.

Held

i) The Court dismissed the revenue's appeal in absence of any substantial question of law.

7. Where the Tribunal remanded the matter without properly appreciating/ understanding the favourable order of CIT(A), the Court set-aside the order of Tribunal and upheld the order of CIT(A) deleting the TP – addition

Rayban Sun Optics India Ltd. [TS-597-HC-2017(DEL)-TP]

Facts

i) The assessee, engaged in the business of manufacturing, importing and selling of sunglasses and prescription frames in India besides exporting raw and semi-finished sunglass frames to its AE entered into 3 classes of international transactions viz., Class I (Manufacturing segment), Class II (Trading segment), Class III (Sale of capital goods). The assessee adopted TNMM as the most appropriate method for benchmarking its international transaction for Class I and II and CUP method for Class III.

ii) In respect of Class I transactions, the TPO observed that the raw material imported by the assessee from its AE was not manufactured by the AE but was procured from a supplier in the same geographical location. Accordingly, he held that there was internal CUP available and held that the CUP would be the most appropriate method. In respect of Class II transactions, the TPO rejected TNMM on the ground that the assessee had imported finished goods from its AE and had sold as such without making any value addition and had acted as a distributor. Accordingly, he held that RPM was the most appropriate method. The TPO accepted CUP as the most appropriate method for Class III transaction.

iii) CIT(A) ruled in the favour of the assessee holding that TNMM was the MAM as regards the transactions under Class I as well as Class II segments.

iv) The Tribunal inadvertently observed that the CIT(A) had accepted TPO's adoption of CUP method for Class I transaction and RPM for Class II transactions. It upheld the application of CUP method and RPM Method. However, it observed that the TPO had not applied CUP and RPM method properly. Accordingly, it remanded the matter to TPO for determining afresh the ALP of Class I international transactions under the CUP method and of Class II international transactions under the RPM as per law.

v) Aggrieved, the assessee appealed before the High Court contending that the Tribunal had committed certain glaring factual errors in understanding the order under appeal before it i.e., the order of the CIT(A).

Held

i) The Court observed that CIT(A) had agreed with the assessee that the transactions both in Class I and II segments had to be benchmarked by applying the TNMM. Therefore, it held that it was factually erroneous on the part of the Tribunal to observe to the contrary.

ii) On perusal of the orders passed by the TPO for AYs 2007-08 to 2010-11 (subsequent years), it observed that the functional profile of the assessee in respect of the three segments had remained same as that of the concerned AY 2004-05 and the TPO had accepted the ALP of the assessee in respect of Class I and II segments for all these subsequent AYs.

iii) Accordingly, it held that when there was no change in the business profile of the Assessee in all these years there was no warrant to uphold the order of the Tribunal remitting the matter to the TPO/AO or to remand the appeal to the Tribunal for a fresh consideration. Therefore, it upheld the order of CIT(A).

8. The Court dismissed the Revenue's appeal against the Tribunal's order remanding the matter to the AO for examination of comparable.

VFS Global Services Pvt. Ltd. [TS-595-HC-2017(BOM)-TP]

Facts

i) The assessee had entered into international transaction of providing UK Visa processing services to its AE and selected 'Cosmic Global' as its comparable in its TP-study.

ii) Before the Tribunal it submitted that 'Cosmic Global' was to be excluded on ground of functional dissimilarity. The Tribunal observed that Cosmic Global's nature of business was distinct from the one carried out by the assessee. It remanded the matter to AO determine the functional comparability of Cosmic Global.

iii) Aggrieved, revenue appealed before the High Court contending that since the assessee had accepted M/s. Cosmic Global Ltd. as functionally comparable, it was not open for the assessee to deviate from the same and accordingly, the Tribunal was not justified in remitting the comparable to the AO.

Held

i) The Court dismissed the appeal of the revenue in absence of any substantial question of law.

9. The Court dismissed revenue's appeal against Tribunal's exclusion of certain comparables in absence of substantial question of law

Alcatel Lucent India Ltd [TS-585-HC-2017(DRL)-TP]

Facts

i) The assessee, engaged in the business of distribution and sale of Digital Switching Equipment, Cellular Exchange Equipment and Other Telecommunication Equipment, provided Contract Software Development (CSD) Services to its AEs.

ii) The TPO rejected the comparables adopted by the assessee and adopted set of new comparables.

iii) The Tribunal held that the following companies selected by the TPO could not be considered as comparable to the assessee:

- E-Infochips Ltd. – on the ground that it had income from software products and services and there was no segmental data available.

- Larsen & Toubro Ltd. – on the ground that it had income from software development services and earned revenue from licensing of products
- Persistent Systems Ltd. – on the ground that it was engaged in diversified services such as software consultancy, software product development and system integration services.
- Infosys Ltd. – on the ground that it was engaged in providing software consulting and products.
- Saxo Ltd. – as it was not functionally similar to the assessee
- Zylog Ltd. – on the ground that this company derived revenue from consultancy services, project and e Governance projects.

i) Aggrieved, the revenue appealed before the High Court.

Held

1. The Court dismissed the appeal of the revenue and held that the Tribunal had assigned clear reasons for exclusion of comparables. Accordingly, it held that no substantial question of law arose.

10. The Court held that where the rates charged by the assessee to related and unrelated parties were not same, CUP method could be used after making adjustments to the rate charged by the assessee to the related and unrelated parties

JP Morgan India Pvt. Ltd. [TS-568-HC-2017(Bom)-TP]

Facts

i) The assessee provided two types of broking services to related as well as unrelated parties viz., Delivery Versus Payment (DVP) and Direct Custodian Settlement (DCS). It benchmarked these international transactions using TNMM as the most appropriate method. The assessee charged brokerage to its related parties @ 0.35% on DVP trades and 0.36% on DCS trades and 0.56% on DVP trades and 0.40% on DCS trades to unrelated parties.

ii) The TPO rejected assessee's adoption of TNMM and applied CUP method since internal CUP was available. The assessee contended before TPO that there were substantial differences in the functions undertaken and risks assumed by the assessee while providing broking services to related parties and unrelated parties and that it had incurred lower cost in providing broking services to related parties than to unrelated parties i.e., research and sales efforts for related parties were 20% lower than the efforts required for unrelated parties. Accordingly, it contended that if internal CUP was to be applied, then adjustment for additional cost incurred in transaction with unrelated parties was to be allowed to the assessee. However, rejecting the assessee's contention, the TPO considered average broking rates charged to unrelated parties.

iii) CIT(A) upheld the TPO's observation that TNMM was not a proper method in view of the availability of internal CUP method. However, it observed that since there were substantial differences between the functions undertaken and risks assumed by the assessee while providing broking services to related parties and unrelated parties, the TPO ought to have granted adjustment sought by the assessee for additional cost incurred for unrelated parties. Accordingly, he deleted the TP addition made by the TPO.

iv) The Tribunal upheld the CIT(A)'s finding that in case of availability of internal CUP method, TNMM could not be applied. It further held that the assessee was to be granted adjustment for additional cost incurred for unrelated parties.

v) Aggrieved, the revenue appealed before High Court.

Held

i) The Court observed that the CIT(A) and the Tribunal had rightly accepted the differences in functions performed and the risk undertaken by the assessee w.r.t the transaction between related and unrelated parties. Accordingly, it held that the rates charged by the assessee to related and unrelated parties could not be the same and that after making adjustments to the rate charged by the assessee to the related and unrelated parties, CUP could be used. Accordingly, it upheld the order of Tribunal deleting the TP adjustment.

C) Tribunal Decisions

11. India-UAE DTAA – Service PE – FTS vs. Royalty – Services provided in the form of sharing or permitting to use the special knowledge or expertise falls within the term 'royalty' under the tax treaty– Held in favour of the revenue

ABB FZ-LLC vs. DCIT [TS-256-ITAT-2017(Bang)]
Assessment Years : 2010-11 and 2011-12

Facts

i) The assessee is UAE-based entity engaged in the business of providing regional service activities for the benefit of ABB legal entities in India, Middle East, and Africa. In pursuance of the regional headquarter service agreement between the assessee and ABB Limited, the assessee has rendered services to ABB Limited. In terms of the agreement, the assessee has received payment from its associate concern.

ii) The assessee claimed that the above amounts are not taxable in India under the tax treaty, as the tax treaty does not have a clause for Fees for Technical Services (FTS) and since this clause has been specifically excluded from the treaty, the taxability would fall under Article 22 of the tax treaty. As per Article 22 of the tax treaty, the amount would be taxable in India only if the entity has a PE in India and in the instant case since there is no PE in India, the sum is not liable to be taxed in India.

iii) The Assessing Officer (AO) held that the services rendered by the assessee would be treated as FTS both under the Income-tax Act, 1961 (the Act) and under the tax treaty as prescribed under Explanation 2 to Section 9(1)(vii) of the Act. In an alternative argument, the AO held that most of the services rendered by the assessee were covered under the definition of 'royalty' as per the Explanation 2(ii), 2(iv) and 2(vi) under Section 9(1)(vi) of the Act, as well as under Article 12(3) of the tax treaty. The Dispute Resolution Panel (DRP) confirmed the order of the AO.

Decision

The Tribunal held in favour of the Revenue as under:

A) Eligibility of tax treaty benefit

i) For the purposes of availing the tax treaty benefit, the assessee is required to furnish a certificate being a resident of the other country. In the present case, though the assessee is incorporated in the UAE, but the Tax Residency Certificate (TRC) has not been furnished before the lower authorities. In the absence of any such findings by the lower authorities and also in the absence of evidence produced by the assessee, it is difficult to give the benefit of the tax treaty to the assessee.

ii) It is for the assessee to furnish the certificate of residence of UAE and the onus is on the assessee to prove that the assessee is managed and controlled wholly in UAE. There is an inbuilt purpose for satisfying these twin conditions namely to prevent treaty shopping and to ensure that the benefits under the tax treaty should only be available to legal entities having *bona fide* business activities in the contracting states.

iii) The assessee has filed a certificate of residence issued by the UAE authorities. However, this certificate was issued only for a period of one year, with effect from 1st April 2012 whereas the AYs under consideration are 2009-10 and 2010-11. Therefore this certificate would not help the assessee as this is not relevant for the years under consideration.

iv) Thus, the assessee cannot be treated as a resident of UAE at the filing of returns of income within the meaning of Article 4 of the tax treaty. Further, the assessee has not provided any evidence showing that the assessee was wholly managed and controlled in UAE. Accordingly, the assessee is not entitled to any tax treaty benefits.

B) Taxability under Article 22 of the tax treaty

i) For the purposes of falling in 'other income' under Article 22 of the tax treaty, it is necessary that the income should not be expressly dealt in Articles 6 to 21 of the tax treaty. If it is held that the income is not falling within Articles 6 to 21, then the said income would fall within the category of 'other income'. The Bengaluru Tribunal in the case of *IBM India P. Ltd vs. DDIT [IT(IT)A Nos. 489 to 498/ Bang/2013* has held that if the income is not falling under any of the categories mentioned in the tax treaty, then it will fall in residual Article 22 of the tax treaty.

ii) In our view, the Article 22 of the tax treaty would become redundant if residual income is to form part of business income. Any income which is also not forming part of business profit under Article 7 as well would also form part of the residual clause under Article 22 of the tax treaty.

C) Re: Permanent Establishment

i) Furnishing of services including consultancy services by the assessee to ABB Ltd for the project in India or with the connected project was for a period of three months after commencing it activities in January 2010. Thus, it fulfills the prerequisite of Service PE and Service PE do not require fixed place PE as well.

ii) In the present age of technology where the services, information, consultancy, management, etc., can be provided with various virtual modes like e-mail, internet, video conference, remote monitoring, remote access to desk-top, etc., through various software, therefore, the argument of fixed place of business raised by the assessee that three employees were rendered services only for 25 days cannot be sustained, as the services can be rendered without the physical presence of employees of the assessee.

iii) The Article 5(2) of the tax treaty is by the way inclusive definition in nature and the definition given in Article 5(1)4 of the tax treaty has been enlarged by Article 5(2) of the tax treaty. Therefore, Article 5(2) of the tax treaty does not require the fulfilment of Article 5(1) of the tax treaty. The Supreme Court has decided the inclusive clauses in 5 *Ramala Sahkari Chini Mills Ltd vs. CCE (2010) (13) SCR 115*. Thus, it has been held that the Article 5(2) is independent clause and the condition of having fixed place PE under Article 5(1) is not attracted for PE under Article 5(2) of the tax treaty.

iv) It is not the stay of the employees for more than 9 months, which is required to be there but it is a fact of rendering of services or activities which were required to be rendered for a period of nine months. On perusal of reply of the assessee, it indicates that the assessee: (a) Has rendered the services through its three employees and their stay was for 25 days; and (b) As is clear from the second reply, the assessee has rendered the services on various occasions from January to March 2010.

v) The providing of services for a period of nine months is stipulated in the period of 12 months. Once the activity of the assessee commenced only in the month of January 2010, then the argument of completing 9 months service before March 2010, is preposterous, implausible and against common sense. It is not expected to complete the nine months between January to March 2010.

vi) The completion of 9 months activities by the enterprise was only conceived in a period of 12 months. However, it is not disputed by the assessee that it continues to render the services with effect from January 2010 and thereafter also in the subsequent assessment year. If we give a literal interpretation to clause 5(2)(i) of the tax treaty, then it is clear that the services are required to be rendered by the enterprise through its employees or other personnel for a period of nine months within any 12 months period.

vii) Relying on the decision of the Supreme Court in the case of *CIT vs. Calcutta Knitwears [2014] 362 ITR 673 (SC)* it has been observed that the requirement of fixed place of business is not applicable to the clauses (2), (4) and (5).

viii) Article 5(2)(i) of the tax treaty provides that the Service PE is not dependent upon the fixed place of business as it is only dependent upon the continuation of the activity the same project or connected project for a period/periods aggregating to more than 9 months within 12 months period. Accordingly, it has been held that the assessee has a Service PE in India. However, the determination of this issue will only have any bearing on the issues under considerations if on the examination of the facts the Tribunal comes to the conclusion that the activities of the assessee does not fall in any of the Article of the tax treaty.

D) Re: Taxability as Royalty

i) The activities rendered by the assessee were in the form of sharing or permitting to use the special knowledge, expertise, and experience of the assessee, and was shared by it with ABB Ltd. squarely falls within the realm of 'royalty', as defined in Article 12(3) of the tax treaty.

ii) The visits of the officials of the assessee were only for the purposes of providing access for using the information pertaining to industrial/commercial/scientific experience belonging to the assessee and to help ABB Ltd. to commercially exploit it. The dominant character of agreement between the assessee and Indian company was for sharing a secret, confidential and IPRs information made available during the years.

iii) The information provided by the assessee to ABB Ltd was in the nature of a know-how contract, given by the assessee so that such know-how can be used by ABB Ltd. for its commercial and industrial purposes and further this special knowledge and experience would remain unrevealed to the public.

iv) This information was not already existing and was supplied by the assessee after its development or creation to ABB Ltd., and there also exist specific provisions concerning the confidentiality of these information. Moreover, the assessee has done little after giving access to this information to ABB Ltd. Thus, the information provided by the assessee to ABB Ltd with the right to use and exploit commercially were concerning industrial, 'commercial or scientific experience activities and would fall under the royalty provision of the tax treaty.

v) In the India-UAE tax treaty in Article 12(3), the term 'royalty' has been differently defined than what it was defined in the India-Thailand tax treaty in the case of *GECF Asia Ltd vs. DDIT [2014] 65 SOT 257 (Mum.)* as the expression alienation and imparting is not used in the treaty. In that case the Tribunal was discussing the issue of India-Thailand tax treaty in respect of 'royalty', and as held if there is imparting or alienation of any know-how while rendering the service on account of information concerning industrial, commercial and scientific expertise than it is royalty and if there is no alienation or use of any right to use of know how or, then it cannot be termed as 'royalty'.

vi) In our view the tax treaty under consideration clearly uses the word for the 'use of' or 'right to use of', commercial, scientific equipment and has not used the word either 'imparting' or 'alienation' of know-how. The tax treaty entered into between the two contracting states is a complete code in itself and is required to be strictly interpreted. The language used in the clause under consideration is plain and unambiguous and therefore reading of words 'alienation' or 'imparting' of know-how in the treaty would be tantamount to rewriting the treaty by this Tribunal, which is not permissible.

vii) Following the rules of interpretation of statute as held by the Supreme Court in the case of *CIT vs. Calcutta Knitwears [2014] 362 ITR 673 (SC)* and in the case of *Raghunath Rai Bajera vs. Punjab National Bank (2007) (2) SCC 230* restrictive meaning is required to be given to the tax treaty between India and UAE.

viii) As we had held that the activities under consideration of the assessee falls under Article 12 of the tax treaty and not under residual clause, therefore the assessee is liable to be taxed in India in accordance with Article 12 of the tax treaty, Section 5 read with Section 9 of the Act.

ix) The following decisions relied on by the assessee are distinguishable on facts of the present case. Moreover, on examination of the agreement and information provided by the assessee to ABB Ltd., with a right to use the said information, was held by us to be 'royalty'. Therefore once payment of any kind received as a consideration for the use of or the right to use, industrial, commercial or scientific equipment by the assessee it will fall within the realm of royalty as per the tax treaty:

- *CIT vs. HEG Ltd [2003] 130 Taxman 72 (MP)*
- *Diamond Services International P. Ltd., vs. UOI [2008] 169 Taxman 201(Bom.),*
- *OECF Asia Limited vs. DD1T [2014] 65 SOT 257 (Mum.)*

Comment

On the issue of royalty, the Mumbai Tribunal in the case of *DDIT vs. Preroy A.G. [2010] 39 SOT 187 (Mum.)* while dealing with India-Switzerland tax treaty observed that the consideration for information concerning industrial, commercial and scientific experience is to be regarded as royalty, only if it is received from imparting know-how. However, providing strategic consulting services, which may entail the use of technical skills and commercial experience by a strategic consultant, does not amount to know-how being imparted to the buyer of the strategic consulting services. Since the assessee was only rendering consultancy services, it did not impart any know-how to the Indian company. Therefore, the receipts cannot be termed as royalty under Article 12(3) of India-Switzerland tax treaty. Various Courts/Tribunal have held on the same line as under:

- *Diamond Services International (P.) Ltd. vs. UOI [2008] 304 ITR 201 (Bom.),*
- *Spice Telecom vs. ITO [2008] 113 TTJ 502 (Bang.),*
- *Mckinsey & Co. (Thailand) Co. Ltd. vs. DDIT [2013] 36 taxmann.com 375 (Mum.),*
- *GECF Asia Ltd. vs. DDIT [2014] 65 SOT 257 (Mum.)*

12. India-Singapore DTAA – Royalty – Article 12 and Section 9(1)(vi) – Whether Payment made for limited right to use of copyrighted information not taxable as Royalty – Held: No; in favour of the assessee

Kinsey Knowledge Centre India Pvt. Ltd. vs. ITO [TS-288-ITAT-2017(Del.)] Assessment Year: 2008-09

Facts

i) The assessee was engaged in the business of export of computer software (including data processing), rendering of support services and acting as a back office for its parent entity.

ii) The assessee obtained access to database maintained by another entity, T Limited, a company incorporated in Singapore and a tax resident therein, for a consideration.

iii) The database contained general information on share price, market, commodity price, currency exchange rates etc. and was publiclly available.

iv) As per the terms of agreement, payment was merely for accessing database and did not have any licence for commercial exploitation of copyright with respect to database maintained and owned exclusively by T Limited.

v) Accordingly, the assessee filed an application under section 195 of the Act with the Tax Officer (TO).

vi) The TO rejected the application of the assessee and directed to withhold tax @10% as per India Singapore tax treaty, treating the payment as Royalty/ Fees for Technical Services (FTS) as per section 9(1)(vi) of the Act.

vii) The assessee contended that the payment was merely in the nature of subscription fee for accessing database of general, publicly available information, which, as per law was not liable to be taxed in India.

viii) In order to treat the payments to T Limited as royalty, it was necessary to establish there was a transfer of all or any rights in respect of copyright of literary, artistic or scientific work. In the present case there was no transfer of any right in respect of copyrights by T Limited and it was a simple case of transfer of copyrighted article. The issue was squarely covered by the decision of the jurisdictional High Court (HC) in the matter of *DIT v. Infrasoft (2014) 264 CTR 329.*

ix) The Revenue contended that the information received by the assessee from T Limited was covered by Explanation 2 clause (iv) to section 9(1)(iv) of the Act and Explanation 2 clause (v) to section 9(1)(iv) of the Act could not be made applicable to the assessee.

Decision

The Tribunal held in favour of the assessee as under:

i) In order to qualify a payment as royalty under Article 12 of the tax treaty, it was necessary to establish that there was a transfer of all or any rights in respect of copyright of literary work.

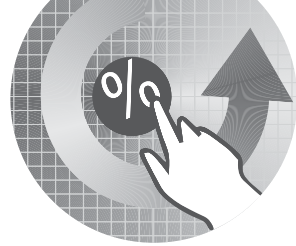
ii) From a perusal of the agreement between the assessee and T Limited, Tribunal noted that the database was merely a compilation of general information relating to share market which was neither relating to T Limited's own experience nor was it secret or divulged information.

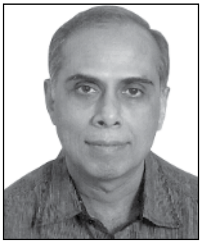
iii) The payment was made by the assessee for merely accessing databases and it did not receive any knowledge as to how the databases were maintained nor did the assessee receive any licence for commercial exploitation of the copyright with regard to the database maintained by T Limited.

iv) That the payment made by the assessee was for the use of 'copyrighted material' rather than use of copyright and hence could not be treated as royalty. .

Comment

The decision has reaffirmed that the payment made for the use of the copyrighted material cannot be taxed as royalty relying on jurisdictional HC in the matter of *DIT vs. Infrasoft Ltd., reported in (2014) 264 CTR 329.* On the issue of taxability of Royalty there are divergent views of various courts and its tax treatment depends upon specific facts of the case.



CA Rajkamal Shah & CA Kush Vora

INDIRECT TAXES
GST Gyan

GST on export and supply to SEZ

As an internationally accepted economic perspective goods and services are exported but not taxes associated with it. Keeping this in view, in the GST regime also exports are not made to tax. As GST is primarily a tax on consumption in India, it is not intended to apply to supplies that are not consumed in India. Most exports are therefore GST-free with zero rated tax enabling exporter to claim refunds with certain built-in safeguards.

Exports & Imports : Treated as deemed to be in the course of Inter-State Trade or Commerce

Being inter – country transaction, export and import is part of Integrated Goods and Services Tax (IGST). Thus, supply of goods and/or services in the course of Import into the territory of India shall be deemed to be a supply of goods and/ or services in the course of inter-state trade or commerce.

Definition of Export

Export may be either Goods or Service or both and are defined as follows in the IGST Act.

As per Section 2(5) of IGST Act : "Export of goods" means taking goods out of India to a place outside India

As per Section 2(6) of IGST Act : "Export of services" means the supply of any service when, –

(i) the supplier of service is located in India;

(ii) the recipient of service is located outside India;

(iii) the place of supply of service is outside India;

(iv) the payment for such service has been received by the supplier of service in convertible foreign exchange; and

(v) the supplier of service and the recipient of service are not merely establishments of a distinct person. The following types of establishments of a person are envisaged as establishment of distinct persons.

   i. an establishment in India and ny other establishment outside India;

   ii. an establishment in a State or Union Territory and any other establishment outside that State or Union Territory; or

   iii. an establishment in a State or Union Territory and any other establishment being a business vertical registered within that State or Union Territory.

Export – Considered as Zero-Rated Supply

The export of Goods and Services is considered as zero rated supply. GST is not leviable on exports. Zero-rated supply refers to items that are taxable, but the rate of tax is nil on their supplies and credit of input tax relating to them can be availed . Export of exempt goods shall also qualify for input tax credit.

Zero Rated Supply – Refund of Unutilised Input Tax Credit or Refund of IGST paid on such exports including that of compensation cess

Exports can be made under two options -

1. Option – 1: Exports may be made under Bond or Letter of Undertaking without payment of integrated tax (IGST)

2. Option – 2: Exports may also be made on payment of integrated tax

Thus a registered person making zero rated supply is eligible to claim refund either by supply under bond or Letter of Undertaking or supply upon payment of IGST.

Accordingly, in case of option -1 that is when exports are made without payment of tax under Bond or LUT, the unutilized credit can be claimed as refund. However when exports are made on payment of tax (IGST), the amount of IGST can be claimed as refund.

Refund of Unutilized credit is not allowed in the following cases:

1. When export supplies are subjected to export duty
2. When drawback is availed
3. When claims refund of the integrated tax paid on such supplies

Time Bound Refund

As per Section 54(6) of CGST Act, ninety per cent of the total amount so claimed shall be refunded on a provisional basis.

Section 54(7) of CGST Act : The proper officer shall issue the order under sub-section (5) within sixty days from the date of receipt of application complete in all respects.

In case of refund not granted within 60 days from the date of making application & received acknowledgement for refund, interest is payable at the rate of 6%.

Making of Refund Application is possible only after filing of Monthly Return GST–3 or GST–3B.

Procedure of Export

To clarify the doubts of exporters and suppliers to SEZ, the Government has issued Notification No. 16/2017 – Central Tax and Circular No. 2/4/2017 and 4/4/2017 to clarify various issues. The same are clarified as under

Option 1(A) – Furnishing of LUT

- The following registered person shall be eligible for submission of Letter of Undertaking in place of a bond

  (a) a status holder as specified in paragraph 5 of the Foreign Trade Policy 2015-20 and One Star, Two Star, Three Star, Four Star and Five Star Export Houses; or

  (b) who has received the due foreign inward remittances amounting to a minimum of 10% of the export turnover, which should not be less than one crore rupees, in the preceding financial year

(c) the claimant should not have been prosecuted for any offence under the Central Goods and Services Tax Act, 2017 or under any of the existing laws where the tax evasion involved more than ₹ 2,50,000/-.

- The Letter of Undertaking shall be furnished in duplicate for a financial year in the annexure to FORM GST RFD – 11 referred to in sub-rule (1) of Rule 96A of the Central Goods and Services Tax Rules, 2017 and it shall be executed by the working partner, the Managing Director or the Company Secretary or the proprietor or by a person duly authorised by such working partner or Board of Directors of such company or proprietor on the letter head of the registered person.
- Circular No. 26/2017- Customs dated 1st July, 2017 has clarified the procedure as prescribed under Rule 96A. Format of LUT is prescribed in the Circular. Letter of Undertaking (LUT) is valid for 12 months.
- A service provider having turnover of less than ₹ 1 crore in the preceding financial year will not be entitled to the benefit of LUT.

Option 1(B) – Furnishing of Bond

- All exporters, not covered above under LUT would submit bond. The procedure for submission and acceptance of bond has been prescribed *vide* circular No. 2/2/2017-GSTdated 4th July, 2017 & Circular No. 4/4/2017-GST, 7th July, 2017.
- FORM RFD – 11 under rule 96A of the CGST Rules requires furnishing a bank guarantee with bond.
- Running bond (separate bond for each consignment / export not required) is required to cover amount of tax involved in export based on estimated tax liability as assessed by exporter.
- The bond is to be furnished on non-judicial stamp paper of the value as applicable in the State in which bond is being furnished.
- Jurisdictional Commissioner to decide amount of bank guarantee depending upon exporter's track record.
- No bank guarantee required if the Commissioner is satisfied.
- In any case the bank guarantee should normally not exceed 15% of the bond amount.
- Bond / LUT to be submitted manually to jurisdictional Deputy/Assistant Commissioner, till module is available on portal.

Exporter may furnish bond/LUT before Central Tax Authority or State Tax Authority till the administrative mechanism for assigning of tax payers to the respective authority is prescribed.

Exports may be allowed under existing LUTs/ Bonds till 31st July 2017. Exporters shall submit the LUTs/bond in the revised format latest by 31st July, 2017.

Common Points relating to Bond/ LUT

- The export invoice shall state **"supply meant for export under bond or letter of undertaking without payment of integrated tax".**
- The Bond/ LUT have to be filled up in Form GST-RFD-11 as prescribed under Rule 97 of GST Rules. However, presently the utility for furnishing of

GST FORM RFD-11 is not available on the GST portal. Hence, the Form GST RFD-11 has to be downloaded from *cbec.gov.in* and furnished manually to the jurisdictional Deputy/Assistant Commissioner

- The Bond/ LUT may be filed with jurisdictional Deputy/ Assistant Commissioner of GST. The exporter is at liberty to furnish the bond before Central Tax Authority or State Tax Authority. However, the Commissioner of Maharashtra, GST has issued a circular *(Trade Circular No. 29T of 2017 Dated 10th July, 2017)* stating that the State Department is not yet administratively ready for the purpose of issuance of Bond/ LUT and therefore for the interim period, the relevant bond/ LUT are to be accepted by Central Tax Authority. This is in line with clarification *vide* para 7 of Circular No. 4/4/ 2017- GST.
- As a transition provision, exports may be allowed under existing Bonds/ LUT's till July 31, 2017. However exporters have to submit the revised format latest by 31st July 2017.
- Form ARE-1, which all along was an important statutory document to avail export benefits both under Excise and Customs Laws, is now dispensed off with the onset of GST.
- No Compensation Cess will be charged on goods exported by an exporter under bond and he will be eligible for refund of input tax credit of Compensation Cess relating to goods exported [on similar lines as refund of input taxes under section 16(3) (a) of the IGST, 2017].

Option 2 – Exports by way of Payment of IGST and claim refund of such tax paid

- If a person is not able to furnish LUT or Bond as per Option-1(A) or 1(B), he may export the goods on payment of IGST. The IGST liability shown on the invoice is only for presentation purpose and not to be collected from the customer;
- The exporter may use the balance availed in his ITC ledgers to discharge the IGST liability shown on the export invoice. In such case, there will be no cash outflow as the IGST liability is discharged by utilization of available ITC. Alternatively, the exporter may make payment of IGST by cash/ bank.
- The IGST liability, thus discharged, either by way of utilizing credit or by payment through cash may be claimed as refund in terms of the provisions of the GST Act.
- In case of goods exported on payment of IGST, refund of IGST can be claimed after the goods have been exported under Rule 96 of CGST Rules.
- For Export of goods the shipping bill is the only document required to be filed with the Customs for making exports. Requirement of filing the ARE 1/ARE 2 has been done away with.
- The shipping bill filed by an exporter shall be deemed to be an application for refund of integrated tax paid on the goods exported out of India and such application shall be deemed to have been filed only after submission of export general manifest and furnishing of a valid return in Form GSTR-3 by the applicant.

Supplies to SEZ

Supplies made to SEZ is treated at par with export. Hence, all the benefits of export relating to input tax credit and refund thereof shall be available to the SEZ suppliers.

Supplies to EOU

Supplies to EOU is not covered under the mechanism of refund of unutilized input tax credit unlike in case of export or supplies to SEZ.

Export of Goods to Nepal and Bhutan treated as Zero Rated and qualify for all the export benefits

Export of goods to Nepal or Bhutan fulfills the condition of GST Law regarding taking goods out of India. Hence, export of goods to Nepal and Bhutan will be treated as zero rated and consequently will also qualify for all the benefits available to zero rated supplies under the GST regime irrespective of the fact that export realisation is received in Indian Currency. However, the definition of 'export of services' in the GST Law requires that the payment for such services should have been received by the supplier of services in convertible foreign exchange and hence, the benefit of export of services to these countries is not allowed.

Filing of Shipping Bill

Quoting GSTIN in Shipping Bill is mandatory if the export product attracts GST for domestic clearance.

Quoting PAN (Permanent Account Number) which is authorised as Import Export code by DGFT would suffice if the exporter exclusively deals with products which are either wholly exempt from GST.

In case of exports by specialised agencies such as United Nations Organization or notified Multilateral Financial Institutions, Embassies and Consulates, the exporter can quote Unique Identity Number instead of GSTIN in the Shipping bill.

Without GSTIN or PAN or UIN, the Shipping bill cannot be filed.

The claim for refund of IGST paid or Input Tax Credit on inputs consumed in goods exported cannot be processed without GSTIN and GST Invoice details in Shipping Bill.

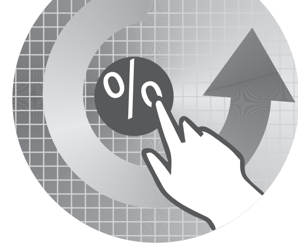
Commercial Invoice information should be provided in the Shipping Bill. Wherever Commercial Invoice is different from Tax Invoice, details of both have to be provided in the Shipping Bill.

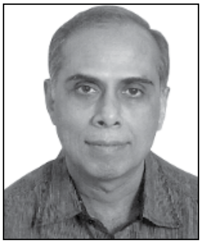
Taxable value and Tax amount should be mentioned against each item in the Shipping bill for processing the refund amount. Multiple tax invoices issued by same GSTIN holder are allowed in one Shipping bill for the same consignee.

State code is part of GSTIN numbering scheme. However, in the Shipping Bill for the field "State of origin" declare the State code from where export goods originated as it was being done before.

Concluding Remark

It appears that the Government is truly sincere in granting the benefit of input tax credit by way of refund. It is hoped that the refund claims shall be allowed without delay in keeping with the spirit of the law.





CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES
GST – Legal Update

NOTIFICATIONS

CGST Act

14/2017 – Central Tax, dated 1-7-2017 (Assigning jurisdiction and power to officers)
CBEC has appointed officers in the category of Director General of GST Intelligence, Audit and invested them with all the required powers under GST & IGST Acts.

15/2017 – Central Tax, dt. 1-7-2017 (Amending CGST Rules notification 10/2017-CT dt. 28-6-2017)
Filing of Form GSTR-3B is inserted in the Rules and the format for the same is notified. Rule 96A is inserted which lays down procedure for Refund of IGST paid on export of goods or services under bond or Letter of Undertaking (LUT). Rules 139 to 162 relating to Inspection, Search and Seizure, Demand and Recovery, Offences and Penalties are inserted.

16/2017 – Central Tax, dt. 7-7-2017 (Conditions and safeguards for furnishing a LUT in place of a bond for export without payment of integrated tax)
A registered person who is a status holder as per Foreign Trade Policy 2015-20 or who has received the due foreign inward remittances of at least 10% of export turnover, which is not less than ₹ 1 crore in the preceding financial year is eligible for submission of LUT in place of a bond. The LUT is to be furnished in duplicate for a year in the annexure to FORM GST RFD – 11.

17/2017 – Central Tax, dt. 27-7-2017 (Seeks to amend the CGST Rules, 2017)
Time limit for filing of FORM GST REG-29 for every person registered under any of the existing laws, who is not liable to be registered under GST is extended up to 30th September.

Rule 34 is substituted to provide that rate of exchange of foreign currency, for determination of value of taxable goods shall be the applicable rate of exchange as notified by the Board and for that of taxable services shall be the applicable rate of exchange determined as per the generally accepted accounting principles.

IGST Act (Rate)

17/2017 – Integrated Tax (Rate), dt. 5-7-2017 (Rescinding Notification No. 15/2017 – Integrated Tax (Rate) dated 30-6-2017)
Exemption granted to SEZ developer or unit from the payment of IGST on import of goods and / or services by Notification No. 15/2017 – Integrated Tax (Rate) dtd. 30-6-2017 is now rescinded.

18/2017 – Integrated Tax (Rate), dt. 5-7-2017 (IGST exemption to SEZs on import of Services by a unit/developer in an SEZ)

Services imported for the authorised operations by a unit or developer in SEZ is exempted from the whole of IGST leviable thereon. Also Notification 64/2017 dt. 5-7-2017 under Customs is issued to grant exemption to a unit or developer of SEZ for authorised operations from the whole of IGST leviable on goods imported under Sec. 7(3) of Customs Tariff Act, 1975 read with Sec. 5 of IGST Act 2017 .

Compensation Cess (Rate)

03/2017 – Compensation Cess (Rate), dt. 18-7-2017 (Compensation Cess rates on cigarettes increased)
Compensation Cess on Cigarettes of various types as mentioned in Entry No. 10 to 15 in the Schedule of Notification No. 1/2017 – Compensation Cess (Rate) dated 28-6-2017 is increased based on parameters.

04/2017 – Compensation Cess (Rate), dt. 20-7-2017 (Exemption to Intra-state supplies of second hand goods). Intra-state supplies of second hand goods received by a person dealing in such goods and paying GST Compensation Cess on outward supply of such second hand goods as per Rule 32(5) of CGST Rules is exempted.

CIRCULARS

CGST

Circular No. 2/2017, dt. 4-7-2017 (Issues related to furnishing of Bond/ Letter of Undertaking for Exports)
Acceptance of the Bond/Letter of Undertaking shall be done by the jurisdictional Deputy / Assistant Commissioner. Also, till the module of furnishing Form GST RFD-11 is available on the common portal, the same shall be furnished manually to the jurisdictional Deputy/Assistant Commissioner.

Circular No. 4/2017, dt. 7-7-2017 (Regarding issues related to Bond/Letter of Undertaking for exports without payment of integrated tax)
Exporters not eligible to furnish Letter of Undertaking will have to submit bond on non-judicial stamp paper of value as applicable in the State in which bond is being furnished. The exporters can furnish a running bond in FORM GST RFD-11 and it would cover the amount of tax involved in the export based on estimated tax liability as assessed by the exporter himself. In case, the bond amount is found insufficient later, a fresh bond has to be furnished.

The amount of Bank Guarantee to be given with bond will be at the discretion of the jurisdictional Commissioner depending on the track record of the exporter. Maximum bank guarantee cannot exceed 15% of the bond amount.

LUT is valid for 12 months

Order No. 1/2017, dt. 21-7-2017 (Extension of date for filing option for composition scheme)
The period for filing an intimation in FORM GST CMP-01 for opting for Composition Scheme is extended up to 15th August, 2017.

IGST

Circular No. 1/1/2017, dt. 7-7-2017 (Clarification on Inter-State movement of various modes of conveyance, carrying goods or passengers or for repairs and maintenance)
Inter-State movement of various modes of conveyance like trains, buses, trucks, tankers, aircrafts; etc., carrying goods or passengers or for repairs & maintenance, between distinct persons may not be treated as supply (except where such movement is for further supply of the same conveyance) and consequently IGST will not be payable on such supply. However, CGST / SGST / IGST, as the case may be, shall be leviable on repairs and maintenance done for such conveyance.

Compensation Cess

Circular No. 1/1/2017 – Compensation Cess, dt. 26-7-2017 (Clarification regarding

applicability of section 16 of the IGST Act, 2017, relating to zero rated supply for the purpose of Compensation Cess on exports)
It clarifies that provisions of section 16 of the IGST Act, 2017, relating to zero rated supply will apply *mutatis mutandis* for the purpose of Compensation Cess (wherever applicable), that is to say that:

a) Exporter will be eligible for refund of Compensation Cess paid on goods exported by him [on similar lines as refund of IGST under section 16(3)(b) of the IGST, 2017]; or

b) No Compensation Cess will be charged on goods exported by an exporter under bond and he will be eligible for refund of input tax credit of Compensation Cess relating to goods exported [on similar lines as refund of input taxes under section 16(3)(a) of the IGST, 2017].

PRESS RELEASES

Press Release dt. 10-7-2017 – GST on Gifts and other benefits by employer to employees
Gifts up to a value of ₹ 50,000/- per year by an employer to his employee are outside the ambit of GST.

a) Since service by an employee to employer in the course of or in relation to his employment is outside the scope of GST, supply in terms of contractual agreement entered into between the employer and the employee will not be subjected to GST.

b) Services such as membership of a club, health and fitness centre provided free of charge to all the employees including that of free housing by the employer, then the same will not be subjected to GST provided GST was paid on its procurement by employer.

Press Release for GST on free food supplied by Religious Places dt. 11-7-2017
No GST is applicable on free food supplied by Anna Kshetras run by religious institutions. Also prasadam supplied by religious places like temples, mosques, churches, gurudwaras, dargahs, etc. attracts Nil CGST and SGST or IGST, as the case may be.

Press Release for Lodging in Hostels dt. 13-7-2017
Services of lodging/boarding in hostels provided by educational institutions which are providing pre-school education and education up to higher secondary school or equivalent or education leading to a qualification recognised by law, are fully exempt from GST. Annual subscription / fees charged as lodging / boarding charges by such educational institutions from its students for hostel accommodation shall not attract GST.

Press Release for further clarification on tax in reverse charge on gold ornaments dt. 13-7-2017
Sale of gold jewellery by an individual to a jeweller will not attract the provisions of Reverse Charge and jeweller will not be liable to pay tax under reverse charge mechanism on such purchases. However, if an unregistered supplier of gold ornaments sells it to registered supplier, the tax under RCM will apply.

Press Release regarding old and used bottles dt. 15-7-2017
It explains margin scheme for dealers of second hand goods in general and old and used bottles in particular as laid down in rule 32(5) of CGST Rules, 2017.

Press Release for clarification on GST rates on hotel accommodation dt. 18-7-2017
Accommodation in any hotel, including 5-star hotels having declared tariff of a unit of accommodation of less than INR 7,500 per unit per day, will attract GST @ 18%. Star rating of hotels is irrelevant for determining the applicable rate of GST.

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law # 1

[2017] 203 Comp Cas 165 (NCLAT)
[Before the National Company Law Appellate Tribunal - New Delhi]
Viavi Solutions India P. Ltd. and others vs. Registrar of Companies, NCT of Delhi and Haryana.

If contraventions and the grounds taken are similar in nature, then the NCLT should be consistent in compounding all such defaults and lesser amount cannot be imposed in one case and higher in another and that different benches of the NCLT are required to be consistent in passing compounding orders and are required to note the precedence as to similar orders passed in case of similar offences.

Brief Case

This Application has been filed before the National Company Law Appellate Tribunal ("Appellate Tribunal") by Viavi Solutions India P. Ltd. and its two directors ("Applicants") against the Order of the National Company Law Tribunal, New Delhi ("NCLT") for five applications towards compounding of offences. The appeal is to challenge the Orders of the NCLT for such five applications for imposing higher fine while compounding of various offences committed by the Applicants under the Companies Act, 1956 ("Act").

The facts are as follows:

1. The Applicants have violated the provisions of various sections under the Act related to non-appointment of whole-time company secretary (Section 383-A), failure to hold an annual general meeting (Section 166), failure to file annual returns (Section 159) and failure to file audited accounts (Section 220).
2. The non-compliances were continuous in nature and attracted fines and penalties under the Act as well under the provisions of the Companies Act, 2013 ("CA").
3. The Applicants rectified the above defaults and filed *suo motu* applications for the compounding of the same.
4. The Applicants filed the application with the NCLT for compounding of the said offences under the provisions of Section 621A of the Act (Section 441 of the CA).
5. The NCLT compounded the above non-compliances and levied penalties which were at least one-fifth of the total fine to be levied on minimum and maximum penalties as imposed under the respective sections.

The Applicants submitted before the Appellate Tribunal the following grounds for challenging the NCLT orders:

1. The NCLT had imposed fines which were disproportionate to the alleged technical defaults made by the Applicants.
2. The NCLT had failed to note that the objective of the provision of Section 621A are not punitive in nature and hence harsh

and burdensome punitive order cannot be passed.

3. In the past, the Company Law Board had taken lenient view for similar contraventions and compounded the same by imposing lesser amount of fine.

4. The NCLT had not considered the facts that contraventions were unintentional and were due to management and organisational changes of the Applicants.

5. The Applicants had rectified the defaults and filed *suo motu* compounding applications.

Judgment and reasoning

Appellate Tribunal allowed the applications and passed the following Order:

a. It was observed that the NCLT had levied a fine of around 1/5th of maximum fine in some of the contraventions and thus retained the said Orders.

b. It was also observed that in case of one application, more than 50% of maximum fine was imposed and for another application, 42% of maximum fine was levied. The Appellate Tribunal observed that levying such higher amount of fine is inconsistent with the fine of 1/5th of maximum fine levied in case of earlier contravention. The Appellate Tribunal modified the said two NCLT Orders and levied a fine of 1/5th of maximum fine applicable in both the cases.

c. In case of default for delay in filing audited accounts, the Appellate Tribunal remitted back the NCLT Order asking to decide the compounding application afresh. It was observed that the NCLT had made an error on calculating the minimum penalty. While it had imposed minimum fine as per the CA, it had not considered the minimum fine payable under the Act for previous four years. The Appellate Tribunal also observed the fine imposed under Section 220 of the Act and Section 129 of the Act for non-filing of accounts and that it imposed punishment by way of imprisonment or fine or both.

The Appellate Tribunal made the following observations after reviewing the provisions of Section 621A of the Act and Section 441 of the CA.

a. The NCLT (erstwhile Company Law Board) had wide powers to compound the offence of the nature provided in the said sections either before or after the institution of any prosecution.

b. Offences under CA, punishable with imprisonment or fine, or both may be compounded with the permission of the Special Court as per Section 441(6)(a) of CA.

c. The submissions made by the Applicants that if the defaults are of similar nature and the grounds taken are also similar, then the NCLT should be consistence in compounding all such defaults and that lesser amount cannot be imposed in one case and higher in another.

d. Different benches of the NCLT are required to be consistent in passing compounding orders and required to note the precedence as to similar orders passed in case of similar offences.

e. The NCLT has to consider (a) the gravity of offence; (b) whether it was intentional or unintentional; (c) period of default; (d) whether default was made good or rectified; and whether the offence is continuous or one time; and whether similar kind of default was committed previously; (e) maximum punishment prescribed under law; (f) report of the RoC; (g) *suo motu* petition before or after RoC notice or during the pendency of prosecution or after imposition of the punishment; and (h) financial condition and share value of the company.

CA Sanjeev Shah

CORPORATE LAWS – RECENT DEVELOPMENTS

Salient features of Companies (Amendment) Act, 2017

Background

- Lok Sabha passed Companies (Amendment) Act, 2017 (Amendment Act) on 27th July 2017 for amending Companies Act, 2013, (2013 Act).
- The amendment is made on the backdrop of recommendations of the Report submitted by the Companies Law Committee in February 2016, comments received from various stakeholders and subsequent Report of the Parliamentary Standing Committee on Finance released in December 2016.

Below are some of the key changes in the Amendment Act as passed by Lok Sabha:

Definitions

- Meaning of "significant influence" and "joint venture" in the definition of "Associate Company" has been altered as under:
  - o "significant influence" would mean control of at least 20% of total voting power, or control of or participation in business decisions under an agreement
  - o "joint venture" would mean a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement
- "Associate company" of a company incorporated outside India can also apply to National Company Law Tribunal (NCLT) to adopt a different financial year i.e. other than April-March.
- "Holding company" would now mean body corporate (whether Indian or overseas) also as a holding company.
- One more layer of person added to be classified as "Key Managerial Personnel" (KMP) i.e. such other officer not more than one level below the directors who is in whole time employment and designated as KMP by the Board.
- Meaning of "Related Party" expended to include investing company or the venturer of a company i.e. body corporate whose investment in the company would result in the company becoming an "associate company" of the body corporate.
- Upper limit for reckoning of "small company" which can be prescribed by Central Government (CG) raised from ₹ 5 crores to ₹ 10 crores for paid-up share capital; And from ₹ 20 crores to ₹ 100 crores for turnover as per profit and loss account for the immediately preceding financial year.
- For reckoning "Subsidiary Company", if holding company *inter alia* exercises or controls more than one-half of the total voting power (as against earlier requirement of total share capital, which meant aggregate of paid-up equity share capital and convertible preference share capital) on its own or together with its subsidiary(ies).

- "Turnover" amended to mean gross amount of revenue recognised in the profit and loss account (earlier aggregate value of realisation of amount made) from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.

Company formation

- In case number of members is reduced below statutory limit of 7 in the case of public company or 2 in case of a private company and such company carries business for more than 6 months then every person who is a member during the period when the company carries on business after those 6 months and who is cognisant of the fact that company is carrying on business with less than 7 or 2 members, shall be severally liable for the debts of the company contracted during that period.
- In case of incorporation of companies, the name availability period is reduced to 20 days (from earlier 60 days) or such other period as may be prescribed from date of approval.

Prospectus

- Every prospectus issued for public company shall state such information and set out reports on financial information as may be specified by SEBI in consultation with CG.

Private placement

- Return of allotment on private placement needs to be filed with Registrar of Companies (ROC) within 15 days of allotment instead of 30 days. Any delay would attract penalty of ₹ 1,000 per day during which default continues but not exceeding ₹ 25 lakhs on company, its promoters and directors.
- Money received under private placement shall not be utilised unless return of allotment is filed with the ROC.
- Private Placement offer letter shall not give any right of renunciation.

Share capital

- Company permitted to issue shares at discount to its creditors if their debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme framed in accordance with guidelines or directions or regulations specified by Reserve Bank of India (RBI).
- Sweat equity shares may be issued any time after registration of the company as against earlier waiting period of completion of 1 year from the date of commencement of business.

Acceptance of deposits

- Amount to be deposited in Deposit Repayment Reserve Account increased from 15% to 20% of the amount of deposits maturing during the following financial year (as against earlier requirement of depositing 15% of deposit amount maturing during the financial year and financial year next following). Such amount shall be deposited on or before the 30th April each year and be kept in a scheduled bank in a separate bank account to be called Deposit Repayment Reserve Account.
- The requirement of providing deposit insurance is omitted.
- Companies which had defaulted in repayment of deposits, can now accept deposits after a period of 5 years from the date of making good the default.
- Penalty for contravention of provisions relating to deposits increased.

Management and administration

Declaration of beneficial interest

- Provisions relating to declaration of beneficial interest completely revamped. For the purpose of declaration of beneficial interest, beneficial interest includes directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to (i) exercise or cause to be exercised any or all of the rights attached to such share; or (ii) receive or participate in any dividend or other distribution in respect of such share.

- New concept of Significant Beneficial Owner (SBO) introduced. SBO means every individual who acting alone or together with one or more person or trust, including a trust and persons resident outside India, who holds beneficial interests, of at least 25% or such % as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control.
- SBO to make declaration of beneficial interest to company.
- Company shall maintain the register of SBO and file a return of SBO and the changes therein with the ROC.

Others

- Requirement of extract of Annual Return (Form MGT-9) as part of Board's Report omitted. Instead, companies are required to place copy of annual return on its website, if any and such web-link shall be disclosed in Board's Report.
- Requirement of disclosure of indebtedness in the Annual Return is omitted.
- Unlisted companies may hold Annual General Meeting (AGM) at any place in India if consent is given in writing or by electronic mode by all the members in advance.
- Only a wholly owned subsidiaries (WOS) of a company incorporated outside India may hold its extraordinary general meeting (EGM) outside India.
- Companies which are mandatorily required to provide electronic voting facility to its members, may transact items that are required to be transacted by means of postal ballot, to be dealt with in general meeting.

Dividend

- Unrealised gains, notional gains or revaluation of assets and any changes in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded in computing profit for declaration of dividend.
- Board of Directors can now declare interim dividend even after closure of the financial year till the holding of AGM. Interim dividend can be declared out of surplus in the profit and loss account (or) out of profits of the financial year for which such interim dividend is sought to be declared (or) out of profits generated in the financial year till the quarter preceding the date of declaration of interim dividend.

Financial statements

- Re-opening of accounts on Court's or Tribunal's orders restricted to a period of up to 8 financial years immediately preceding the current financial year unless directed by CG to be preserved for a longer period.
- Appeal against the order of National Financial Reporting Authority (NFRA) may be preferred to National Company Law Appellate Tribunal (NCLAT) instead of separate Appellate Authority to be constituted.
- CEO mandatorily required to sign the financial statement irrespective of whether he is a Director of the company.
- In case of listed companies, the onus of annual evaluation of performance of the Board, its Committees and individual directors which was earlier cast on the Board, is now withdrawn and only a statement indicating the manner in which such annual evaluation is made needs to be mentioned in the Board's Report.
- Disclosures which have been provided in financial statements need not be duplicated in the Board's Report and should instead be cross-referenced.
- CG may prescribe abridged form of Board's Report for small companies and One Person Company (OPC).

CSR and auditors

- Applicability of Corporate Social Responsibility (CSR) will now be determined on the basis of net profit, turnover and net worth as per financial statement of immediately preceding financial year instead of immediately preceding 3 financial years.

- Only listed companies will have to place copy of financial statements of their subsidiaries on their website which was earlier applicable to all companies having subsidiaries.
- Mandatory requirement for ratification of appointment of Auditor by members at every AGM omitted.
- A person who "directly" or "indirectly" renders any service referred to in section 144 to a company, or its holding company or its subsidiary company, shall not be eligible to be appointed as an Auditor.
- Auditor's reporting on Internal Financial Controls (IFC) restricted to the financial statements instead of IFC system.
- When the auditor has been convicted of any default in compliance with the provisions of Sections 139, 143, 144 or 145, the liability of auditor to pay damages for loss arising out of incorrect or misleading statements made in the audit report will be to company, statutory bodies or authorities and members and creditors instead of any other persons at large.
- In case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, colluded in any fraud shall only be liable, instead of joint and several liability of the audit firm.

Board, Committees of the Board and loans to Directors

- Residential status of a director to be calculated based on stay in India during the "financial year" instead of "previous calendar year" and in case of newly incorporated company, residence criteria needs to be calculated proportionately at the end of the financial year in which the company is incorporated.
- Criteria for appointment of Independent Director (ID) revised.
- In addition to Director's Identification Number (DIN), CG may prescribe any other identification number to be treated as DIN for the purpose of 2013 Act.
- Requirement of deposit of ₹ 100,000 is not required in case of appointment of ID or directors nominated by Nomination and Remuneration Committee (NRC) or a director recommended by the Board in the absence of NRC.
- Board's right to appoint directors in casual vacancy in public companies now extended to all companies and such appointment to be subsequently regularised by the members of the company in immediate next general meeting.
- Person appointed as director in a company which has already defaulted in filing of financial statements / annual return (or) repayment of deposits (or) payment of interest (or) redemption of debentures (or) payment of interest thereon (or) payment of dividend, will not attract disqualification for a period of 6 months from the date of his appointment as director to allow making good the default made.
- Directorships in dormant companies to be excluded for computing limit of directorships of 20 companies.
- Director of defaulting company to vacate his office as director from companies other than defaulting company.
- Mandatory requirement of constituting Audit Committee and NRC to apply only to listed public companies instead of 'listed companies'.
- Provision relating to prohibition on forward dealings in securities by director /KMP and prohibition on insider trading deleted.

Related Party Transaction (RPT)

- In case Audit Committee does not approve any RPT (other than those which are in the ordinary course of business and on arm's length basis), it shall give its recommendations to the Board.

- Audit Committee may ratify RPT not exceeding ₹ 1 crore entered into by a director / officer of the company without its approval. Such ratification should be done within 3 months of entering into RPT and if such RPT is not ratified by Audit Committee such RPT shall be voidable at an option of the Audit Committee. Further, such director shall also indemnify the company for any loss arising from such RPT.
- RPT (other than those which are in the ordinary course of business and on arm's length basis) between a holding company and its Wholly Owned Subsidiary (WOS) will be exempt from Audit Committee approval.
- Securities Premium also to be taken into consideration for reckoning aggregate borrowing limits under Section 180 of the 2013 Act.
- The restrictions on voting by related party(ies) in general meeting for approval of RPT will not apply where 90% or more members (in number) are relatives of promoters or related parties.
- Non-ratification of related party transaction shall be voidable at the option of the Board or shareholders, as the case may be.

Loan to directors and interested parties

- Provisions of section 185 revamped in entirety.
- Blanket ban on giving loan, providing guarantee or security in relation to loans to any director of the company or its holding company or any partner or relative of any such director or any firm in which such director or his relative is a partner.
- Advancing loan including loan representing a book debt or providing guarantee or security in relation to loans to "any person in whom any of the director of the company is interested" (as defined) now permitted subject to approval of members by special resolution only in relation to principal business activities of the borrowing company.
- Penalties laid down if funds are utilised in contravention of provisions of Section 185.
- Prohibition under Section 185 will not apply to company (which in the ordinary course of its business provides loans (or) gives guarantees etc.) if it charges interest not less than the rate of prevailing yield of 1 year, 3 year, 5 year or 10 year Government security closest to the tenor of the loan.

Intercorporate loans, investment etc.

- Requirement of taking shareholders' approval by special resolution for giving loan / making investment, providing securities etc. in excess of 60% of paid-up capital, free reserves and securities premium (or) 100% of free reserves and securities premium will not apply to loan / guarantee given by holding company to its WOS or joint venture company; or for acquisition of securities by holding company in its WOS.
- Investment made by banking company, insurance company or housing finance company in the ordinary course of its business will be exempt from compliance with various provisions of section 186

Appointment and Remuneration of Managerial Personnel

- A person beyond 70 years of age may be appointed as Managing Director (MD) or Whole-time Director (WTD) or Manager even if the appointment has not been approved by special resolution provided that votes cast in favour exceeds the votes cast against the resolution and the Central Government is satisfied on an application made by the Board that such appointment is most beneficial to the company.
- Managerial remuneration exceeding 11% of net profits may be paid by passing special resolution in general meeting without the requirement of approval of CG.

- In case of default in payment of dues to bank or public financial institution or non-convertible debenture holders or other secured creditor, managerial remuneration can be paid only after with prior approval of concerned aforesaid creditor is taken.
- In case of loss or inadequacy of profits, remuneration can only be paid in accordance with Schedule V of the Act.
- If managerial person draws remuneration in excess of the limits laid down under 2013 Act, the same shall be refunded by director within 2 years or lesser period as may be allowed by the company and until such sum is refunded, the director shall hold it in trust for the company.
- The power for waiver in recovery of excess remuneration shifted from Central Government to shareholders of the company and concerned creditor.
- The auditor of the company to make a statement as to whether payment of remuneration to directors is in accordance with the compliance of the Act and whether the same is in excess of the limit laid down under the Act.

Registered valuer

- Restriction on appointment of Registered Valuer for valuation of assets diluted. Now, Registered Valuer cannot be appointed for valuation of such assets, in which he has a direct or indirect interest or becomes interested during a period of 3 years prior to his appointment as valuer or 3 years after valuation of assets conducted by him.

Companies incorporated outside India

- Provision relating to winding up prescribed in 2013 Act Chapter XX shall apply to closure of place of business by a foreign company, in case it has raised monies through offer or issue of securities which have not been repaid or redeemed. In other words, foreign companies which has not raised money, the provision of winding up will not apply.

Filing fees

- Delay in filing of Annual Return / financial statement will attract additional fees @ of not less than ₹ 100 per day. Different amounts may be prescribed for different classes of companies.
- Filing of various documents with ROC after the expiry of prescribed period can be done on payment of such additional fee as may be prescribed. Different amounts may be prescribed for different classes of companies.
- Default on 2 or more occasions with regard to submission, filings, registration, etc. of documents would attract higher additional fee.

Others

- Constitution of Special Court changed.
- NCLT to compound offences punishable with fine as well as those offences punishable with fine or imprisonment.
- Rationalisation of provision relating to punishment for fraud depending upon the amount involved in fraud.

Conclusion

Based on the information available while going into press, the Amendment Act as passed by Lok Sabha has been introduced in Rajya Sabha for passing. Assuming Rajya Sabha passes the Bill in the same form as approved by Lok Sabha, the Amendment Act, then will require assent of President of India and thereafter it will be notified in the Official Gazette. CG may notify different date(s) for coming into force of various provision(s) of the Amendment Act and will specify the same in the Official Gazette.

The proposed amendments provides clarity in various matters and is aimed at reducing compliance burden and facilitate ease of doing business in India.




CA
Amit Purohit

CA
Deepak K. Shah

CA
Sandeep Chhajer

CA
Yogesh Amal

In Focus – Accounting and Auditing

September is approaching nearby and we are busy in finalising our Audits, growing economy comes with fast and changing environment. There are many changes in the existing laws, introduction of new laws, etc. We being integral part of development of India, are required to keep pace with such changes and keep ourselves updated. With the introduction of IND-AS (Converged IFRS) to specified companies, it has changed the financial statements presentation and accounting altogether. But for the group of enterprises which are not covered under the ambit of IND-AS, Accounting Standards (iGAAP) are applicable. There are modification/changes in the old accounting standards as well, which are applicable to companies for the preparation and presentation of the financial statements for the Financial Year 2016-17 onwards. To keep our members updated with such changes we have provided key differences between the Old Accounting Standards and Revised Accounting Standards.

MCA *vide* Notification G.S.R. 364(E) dated 30th March 2016 made amendment to Companies (Accounting Standards) Rules, 2006 also called as Companies (Accounting Standards) Amendment Rules, 2016 and made changes to the following Accounting Standards

i. AS 2, Valuation of Inventories

ii. AS 4, Contingencies and Events Occurring After the Balance Sheet Date

iii. AS 10, Property, Plant and Equipment

iv. AS 13, Accounting for Investments

v. AS 14, Accounting for Amalgamations

vi. AS 21, Consolidated Financial Statements

vii. AS 29, Provisions, Contingent Liabilities and Contingent Assets

Whereas, AS 6, Depreciation Accounting stands omitted.

These amendments were applicable to Corporates and with the view to harmonise Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) for non-corporate entities and the amendments to the Accounting Standards notified by the Central Government, the Council decided that the amendments notified by the Central Government after appropriate changes shall also be incorporated in the Accounting Standards issued by the ICAI. Accordingly in 359th meeting held on August 16-17, 2016 ICAI made the required changes. For non-corporate entities these changes shall be applicable from accounting periods commencing on or after April 1, 2017. However, early application of the aforementioned amendments is permitted.

AS 2 – Valuation of Inventories

Changes were made in paragraphs Nos. 4 & 27

Old Para	Revised/ New Para	Position under New Standard	Position under Old Standard
4	4	**Exclusion from Inventories** If spare parts or servicing equipments or standby equipments fulfil recognition criteria as per AS 10 (revised) then the same shall be recognised as an item of Property, Plant & Equipment and thus shall not be classified as Inventories	Till now Machinery spares which can be used only for an item of fixed assets were excluded from the scope of Inventories. Rest all were required to be categorised as Inventories.
27	27	**Disclosures** Residual Head called "Others" is added under Classification for disclosure purpose Organisations now have an option to disclose their inventories under the head "Others" which cannot be classified under any other specified heads	**Disclosures** Organisations were mandated to classify their inventories in the specified heads only

AS 4 – Contingencies and Events Occurring after the Balance Sheet date

Changes were made in paragraph no. 8.5 & 14

Old Para	Revised/ New Para	Position under New Standard	Position under Old Standard
8.5 & 14	8.5 & 14	**Scope** Earlier Revised Schedule VI/ Schedule III stated that Proposed Dividend are not to be recorded, but there was AS 4 which mandated recording of such Dividend. So after this amendment, no impact will be on Balance Sheet (i.e. proposed dividend not to be accounted as Liability) Disclosure in Notes to Accounts required	**Scope** Proposed Dividend would form part of Appropriations on Profit & Loss A/c and Provision for dividend is created which is grouped under Current Liabilities

AS 13 – Accounting for Investments

Changes were made in paragraph no. 20 & 30

Old Para	Revised/ New Para	Remarks / Implication (New Position)	Old Position
20 & 30	20 & 30	**Scope** As per revised AS-13, Investment properties will now need to be accounted under cost model as prescribed under "AS-10-Property, Plant and Equipment" which mandates depreciation on Properties. As a result, depreciation on such properties will have to be provided as per the guidance given in revised AS-10 and Schedule II of the Companies Act, 2013. Further, the disclosure requirements of both revised AS-13 as well as AS-10 will need to be followed.	**Scope** Under pre-revised AS-13, there was ambiguity with no specific guidance as regards depreciation on Investment properties, resulting in companies following varied practices viz. (1) Providing depreciation on such properties based on the rates given under the Schedule XIV / Schedule II of the Companies Act, 1956/ 2013 respectively (based on the old circular from the Department of Company Affairs) or (2) not providing the depreciation by treating such investments as long-term investment (at cost).

AS 14 – Accounting for Amalgamations

Changes were made in paragraph 23:

Old Para	Revised/ New Para	Remarks / Implication (New Position)	Old Position
23	23	**Treatment of Reserves Specified in a Scheme of Amalgamation** Section 230 as well as 232 of the Companies Act, 2013, requires accounting treatment mentioned in the scheme of compromise or arrangement to be in conformity with the AS. Thus, under the new Companies Act, any scheme of amalgamation sanctioned under the said Act cannot deviate from the accounting treatment of reserves as envisaged in AS 14. Hence the question of disclosures of deviations does not arise.	**Treatment of Reserves Specified in A Scheme of Amalgamation** Earlier as per AS 14, in case the scheme of amalgamation provided for different treatment of reserves (of the transferor company) as compared to the treatment envisaged under AS 14, then certain disclosures were required to be made in the financial statements as regards the deviations.

Old Para	Revised/ New Para	Remarks / Implication (New Position)	Old Position
		As a result, the revised para 23 of revised AS 14 now specifically provides that the said para shall not apply to any scheme of amalgamation approved under the Companies Act, 2013. The same implies that para 23 now applies only to schemes sanctioned under Companies Act, 1956.	

AS 21 – Consolidated Financial Statements

Changes were made in paragraph no. 9:

Old Para	Revised/ New Para	Remarks / Implication (New Position)	Old Position
9	9	**Scope** According to the amendment in paragraph No. 9 of the Accounting Standard 21 "Consolidated Financial Statements", a company, which has no subsidiary but has one or more associate/ joint ventures, is required to prepare consolidated financial statements. Accordingly, in case of a Company having only Associates or Joint Venture requires to prepare CFS applying equity method as stated in AS 23 or Proportionate Consolidation Method as stated in AS 27	**Scope** Under the Accounting Standard 21 "Consolidated Financial Statements", Consolidated Financial Statements (CFS) are to be prepared only if company have one or more subsidiaries and if it is required by the law. There was a clarification in Accounting Standard 23 "Accounting for Investments in Associates in Consolidated Financial Statements" and Accounting Standard 27 "Financial Reporting of Interests in Joint Venture", that if an enterprise presents CFS, then only it should account investment in Associates and Joint ventures in accordance with AS 23 and 27 respectively in its CFS. However, under the Companies Act, 2013, a company, which has no subsidiary but has one or more associate/ joint ventures, is required to prepare CFS.

AS 29 – Provisions, Contingent Liabilities and Contingent Assets

Changes were made in paragraph no. 35

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
35	35	**Measurement** According to the amendment done in paragraph 35 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", provision for decommissioning, restoration and other similar liabilities which are recognised as cost of Property, Plant and Equipment requires to be discounted. It further states that discount rate should be pre-tax and periodic unwinding of such discount should be recognised in the statement of profit and loss. As per transition provision of the Standards all existing provisions for decommissioning, restoration should be discounted prospectively, with the corresponding effect to be given to the related item of property, plant and equipment	**Measurement** Upfront provision was required to be created for asset retirement / site restoration obligations etc. The provision amount should not be discounted to its present value

AS 10 – Property, Plant and Equipment

Old Accounting Standards AS 10 & AS 6 are merged into one standard i.e., AS 10 – Property, Plant & Equipment. This is the standard which is having maximum number of amendments.

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
		Title Title to be modified wherever reference to AS 10 is given. Earlier standard on Depreciation and on Accounting for Fixed Assets merged into single standard. Thus AS 6 stands withdrawn.	**Title** Separate Standards for Accounting of Fixed Assets and Depreciation
3	3	**Scope** Expenditure on real estate shall now be governed by Revised AS 10 Biological Asset = Living Plant or Animal (Revised AS 10 does not apply to Biological asset) Bearer Plant = Plant that is used in production or supply of agricultural produces and is expected to bear produce for a period more than 12 months (Revised AS 10 applies to Bearer Plants)	**Scope** Standard was not applicable to expenditure on real estate There was no specific concept / definition of Biological asset or Bearer plant

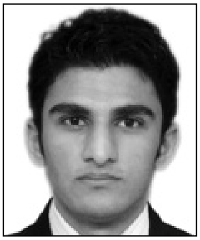
Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
8.2	8	**Machinery Spares** Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory. Since such spare parts or equipments can be used only in connection to fixed assets and their use is irregular, the same shall be classified as Property, Plant, Equipment	**Machinery Spares** Usually charged to Profit & Loss A/c if such item of spares can be used only in connection with an item of fixed asset then its total cost may be allocated on systematic basis over a period not exceeding useful life of principal item An organisation may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material.
6.1	7	**Recognition Criteria** Property, Plant and Equipment are tangible items that are held for use in the production or supply of goods or services, or for rentals to others or for administrative purposes and are expected to be used for a period more than 12 months Following criteria should be satisfied in addition to meeting the definition of Property, Plant & Equipment: 1. It is probable that future economic benefits associated with the item will flow to the entity and 2. The cost of the item can be measured reliably	**Recognition Criteria** Under old standard, future economic benefits or measurability of cost were not taken into account
NIL	17(c)	**Cost of Dismantling & removal of an item** The cost of PPE shall include the estimate of obligation which an organisation incurs either when the item is acquired or as a consequence of using an item (except for the purpose of producing inventories)	**Cost of dismantling & removal of an item** Such future obligation would not form part of cost of Fixed Assets

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
NIL	14	**Cost of major inspection** Cost of major inspection to be capitalised. Further if any carrying amount is remaining the same should be derecognised (i.e. removed from the books)	**Cost of major inspection** No specific guidance was available in this context.
12.1	13	**Subsequent Expenditure** If satisfies the recognition criteria for recognition as property, plant & equipment (i.e. evaluated on same recognition principles as initial cost)	**Subsequent Expenditure** To be capitalised only if they increase the future benefits from the existing assets beyond its previously assessed standard of performance
8.3	45 & 46	**Componentisation** Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately For this, an organisation shall allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and then depreciate each such part separately. This process in general terms is known as "Componentisation"	**Componentisation** The accounting for an item of fixed asset may be improved if the total expenditure thereon is allocated to its component parts, provided they are in practice separable and estimates are made of the useful lives of these components. Term may be suggests that such practice is optional.
13.1 to 13.5	33 to 44	**Cost Model or Revaluation Model as its accounting policy** If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued Enterprise can choose either of the model and apply that policy to an entire class of PPE 1. Cost Model: Carry an item of PPE at cost less accumulated depreciation and impairment losses 2. Revaluation Model: Carry an item of PPE at Fair Value (usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers)	**Cost Model or Revaluation Model as its accounting policy** Provides an option for selection of assets within a class for revaluation. Recognises revaluation model but does not require adoption of fair value basis as its accounting policy In case fixed assets are not carried at cost, necessary disclosures should be made to highlight such a fact. Further, revaluation should not result to a situation where net book value (after revaluation) is greater than the recoverable amount

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
10	23	**Self-Constructed Assets- Abnormal Loss** Cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset	**Self-Constructed Assets – Abnormal Loss** No such specific exclusion
NIL	25	**Deferred Credit Terms i.e., Discounting when payment beyond normal credit period** If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with AS 16 Example: If the vendor sells an item of PPE to Co. A for ₹ 1.15 Lacs with credit period of 30 days while that vendor sells the same item of PPE to Co. B for ₹ 1 Lakh with spot payment condition then as per revised AS 10, Co. A needs to recognise additional ₹ 15,000 as interest for 30 days. The above interest can be capitalised provided it satisfies the criteria under AS 16 Borrowing Cost	**Deferred Credit Terms i.e., Discounting when payment beyond normal credit period** Such split into price paid for Fixed Asset and paid towards interest was not required
23	53	**Review of Residual value and Useful Life**	**Review of Residual value and Useful Life**
		At least at each year end such review should be undertaken and deviation if any from the previous estimates should be evaluated.	The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. (The term may be suggest that such review is optional)
			Where there is a revision of the estimated useful life of an asset, the unamortised depreciable amount should be charged over the revised remaining useful life.

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
15	63	**Review of Depreciation Method** The principle laid in the revised standard states that depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise and thus any significant change in observed in expected pattern of consumption of future economic benefits shall lead to change in method of depreciation. This change in the method will not be considered as change in the accounting policy.	**Review of Depreciation Method** Change in depreciation method can be made only if the adoption of new method is required by statute or for compliance with an AS or if it is considered that change would result in more appropriate preparation or presentation of the financial statements
15	63	**Change in Depreciation Method** Considered as change in Accounting Estimate and thus prospective effect Prospective Effect means that there is no need to recompute the depreciation for past years	**Change in Depreciation Method** Considered as change in Accounting Policy and thus retrospective effect When a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising recomputation of depreciation in accordance with the new method is adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency is charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus is credited to the statement of profit and loss.

Old Para	Revised/ New Para	Remarks/Implication (New Position)	Old Position
11.1	26	**Non-Monetary Consideration** The item of PPE acquired shall be recognised in the books at "Fair Value" unless (i) the transaction lacks commercial substance and (ii) Fair value is not measurable for both asset acquired and asset given up.	**Non-Monetary Consideration** Organisation can either record the fixed asset acquired at Fair value or at the net book value of asset given up. Option is available.
NIL	44	**Revaluation of Asset**	**Revaluation of Asset**
		The revaluation surplus included in owners' interests in respect of an item of property, plant and equipment may be transferred to the revenue reserves when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.	Neither existing AS 10 nor existing AS 6 deals with the transfers from revaluation surplus. For this, Institute has issued a Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets. The Guidance Note provides that if a company has transferred the difference between the revalued figure and the book value of fixed assets to the 'Revaluation Reserve' and has charged the additional depreciation related thereto to its profit and loss account, it is possible to transfer an amount equivalent to accumulated additional depreciation from the revaluation reserve to the profit and loss account or to the general reserve as the circumstances may permit, provided suitable disclosure is made in the accounts. However, the said Guidance Note also recognises that it would be prudent not to charge the additional depreciation arising due to revaluation against the revaluation reserve.



Rahul Sarda, *Advocate*

BEST OF THE REST

1. Maharashtra Stamp Act, 1948 – Insufficiently stamped document – Evidence Act – Can be read in evidence

A suit for recovery was filed by the Respondent seeking a decree against the first Appellant in the sum of ₹ 3,98,02,466/- at the rate of 13.50% p.a. on the principal amount of ₹ 2,00,00,000/- and other reliefs. The case made out by the Respondent is that it was supplying certain raw material required for manufacturing polyester filaments to the second Appellant. Prior to 6th September 2005, the second defendant was enjoying the credit exposure limit of ₹ 11.25 crores with the Respondent. On 6th September 2005, the exposure limit was offered to be enhanced to ₹ 13.25 crores subject to the condition of reducing the exposure to the present level of ₹ 11.25 crores. This was subject to additional condition of the first Appellant mortgaging suit property in favour of the Respondent.

According to the Respondent, a memorandum dated 9th September 2005, was executed by the first Appellant recording deposit of title deeds in respect of the suit property with the Respondent. The memorandum records that the mortgage shall continue as security for the credit exposure granted to the second defendant which could be released only upon reduction of additional credit exposure of ₹ 2,00,00,000/-, by 31st March 2006. An objection as regards insufficiency of stamp was raised.

Held, *prima facie,* there was no dispute about the execution of the document. As far as the objection of inadequacy of stamp was concerned, even assuming that there is some merit in the same, by paying deficit stamp duty and penalty in accordance with section 34 of the Maharashtra Stamp Act, the document can always be read in evidence. The issue as to legality of the document can be gone into at the time of final hearing. Suffice it to say that *prima facie,* there is no dispute about the execution and the contents of the document. Therefore, the document could be read in evidence at this stage.

Dr. Mahendra Kumar Modi & Anr. vs. Gujarat State Fertilizers and Chemicals Ltd. 2017 (3) MhLJ 114 (Bom.)

2. Maharashtra Stamp Act, 1948 – Procedure when insufficiently stamped document is presented in Court – Failure to follow procedure – Pragmatic approach when revenue recovered and purpose of Stamp Act served

Whenever an insufficiently stamped/ unstamped document is presented in Court, the Court must impound the document and send it for adjudication. Only after the stamp duty is paid, the said document can be admitted in evidence. The DRT, instead of sending the insufficiently stamped document presented before it for adjudication, returned the same to the Petitioner for stamping which was done. In appeal before the DRAT, since the correct procedure was not followed by the DRT, DRAT returned documents for following correct procedure. Held by the High Court, the DRAT should have taken a pragmatic and practical view of the matter. When the purpose for which documents are to be impounded is served viz., the revenue was secured in the form of payment of stamp duty, no useful purpose would be served by sending the matter back. The Respondents against whom the claim application had been filed could not protract the proceedings on technicalities to defeat the claim of the Petitioner. Hence, the order of the DRAT was set aside.

Asset Reconstruction Company (India) Ltd. vs. Alpha and Omega Diagnostics (India) Ltd. 2017 (3) MhLJ 315 (Bom.)

3. Transfer of Property Act – When does transfer take effect – Contempt of Court by transferring property in violation of Court's order

By order dated 8-5-2014, the Supreme Court directed that "till further orders, capital assets of the Company shall not be disposed of without taking permission of this Court". The Appellant seeks to highlight disobedience and violation of this order dated 8-5-2014 passed by the Supreme Court.

On 2-7-2014, by a registered deed, the property in question came to be transferred while the order dated 8-5-2014 was still in operation. The question that arose before the Court was whether there was contempt of the Court's order.

On behalf of the alleged contemnors, it was contended that conveyance deed was executed on 4-4-2013 on which date the entire consideration stood paid by the transferee and was credited to the account of the Company and as such the title passed in favour of the transferee well before the order of 8-5-2014 and what was done on 2-7-2014 was a mere ministerial act. The documents presented for registration in April 2013 were not accepted for want of adequate stamp and registration fees. This infirmity was removed and the documents were then presented for registration. In such circumstances the order of 8-5-2014 was not in any way violated by them.

Held, the document dated 4-4-2013 did not by itself create any interest nor did the title pass upon execution of such document on 4-4-2013 but it was only after the registration on 2-.7-2014 that the title passed from the Company in favour of the transferee. In so far as the issue of transfer is concerned, section 54 of the Transfer of Property Act was the governing principle, which was quite clear. It was the date of registration of document that was crucial inasmuch as the transfer was effected and the title passes only upon registration. Viewed thus, it is clear that the property was transferred in the teeth of the order of 8-5-2014 and *ex facie* there has been violation of the order passed by the Supreme Court. It is crucial to note that on 8-5-2014, the company had appeared on caveat before this Court and certainly had express knowledge about the order of 8-5-2014. It was party to the proceedings and was bound by the order passed by this Court in every respect.

However, the purchasers of the property could not be held to be in contempt as there was no material to show that a copy of the order dated 8-5-2014 was served on them and they were also not parties to the proceedings. On facts, the company and its directors/servants were certainly guilty of transgressing or violating the order of 8-5-2014 but the transferee and its Directors/servants were held to not have violated the order.

Ghanshyam Sarda vs. Sashikant Jha, Director, M/s. J. K. Jute Mills Company Ltd. & Ors. 2017 (3) MhLJ 19 (SC)

Kishor Vanjara, *Tax Consultant*

Tax Articles for Your Reference

Articles published in Taxman, Current Tax Report (CTR), The Tax Referencer (TTR), Income Tax Report (ITR), ITR's Tribunal Tax Reports (ITR Tribunal), The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant Journal (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Company Case, Times of India and Economic Times for the period June to July 2017 has been arranged and indexed topic-wise.

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CA Ketan Vajani & CA Nishtha Pandya
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 8th August, 2017 and 8th September, 2017 are being reported as under.

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 4th August, 2017.

LIFE MEMBERSHIP

1	Mr. Pitale Abhay Gokuldas	CA	Pune
2	Mr. Taneja Ashwani Tekchand	Advocate	New Delhi
3	Mr. Telang Ranjeet Dasharath	ITP	Kolhapur
4	Mr. Shah Gautam Velji	CA	Mumbai
5	Mr. Athavale Rajesh Sharad	CA	Mumbai
6	Mr. Desai Hiresh Udaykumar	CA	Mumbai
7	Mr. Gandhi Nishit Madhukar	Advocate	Mumbai
8	Mr. Shaparia Paresh Chandrakant	CA	Mumbai

Ordinary Membership

1	Miss Choudhary Barkha Lalchand	CA	Mumbai
2	Mr. Rawat Vishu Sukhbirsingh	CA	Pune
3	Ms. Bulchandani Loshika Kamal	Advocate	Mumbai
4	Ms. Gupta Shilpa Aditya	CA	Mumbai
5	Mr. Basheer Ahmed Kenjar	Advocate	Mumbai
6	Mr. Basu Ranit Rajat	Advocate	Mumbai
7	Miss Pandya Parul Chandrakant	Advocate	Mumbai
8	Mrs. Vasa Jaini Hardik	CA	Mumbai
9	Mr. Mehta Ankoosh Kirit	Advocate	Mumbai
10	Mr. Mehta Jaydeep Purujit	Advocate	Mumbai
11	Mr. Pathak Shreedhar Narayan	CA	Pune
12	Mr. Vaidya Sunil Suresh	CA	Pune
13	Mr. Ayare Bhalchandra Madhukar	CA	Mumbai
14	Mr. Jain Mayur Lalitkumar	CA	Mumbai
15	Mr. Siddiqui Ozair Ahmed Anwarul Haque	Advocate	Mumbai
16	Mr. Pachchalla Samba Murthy P. V. Subba Rao	CA	Secunderabad

17	Mr. Remella Lakshmi Narayana Yethi Narasimha	CA	Hyderabad
18	Miss Lalan Ridhi Sanjeev	CA	Mumbai
19	Mr. Chhajer Sandeep Dilip	CA	Mumbai
20	Mr. Mishra Sanjay Surajnath	ITP	Mumbai
21	Mr. Thakur Rahul Chandrakant	Advocate/CA	Mumbai
22	Mr. Loya Parikshit Rajesh	CA	Nagpur
23	Mr. Thakkar Harshit Shailesh	CA	Mumbai
24	Ms. Sheth Jigna Vishal	CA	Mumbai
25	Mr. Surte Aditya Suhas	CA	Mumbai
26	Mr. Lodaya Karan Deepak	CA	Mumbai
27	Mr. Singh Harpreet Avtar Singh	CA	New Delhi

Student Membership

1	Miss. Merchant Pooja Praful	CS	Mumbai
2	Mr. Dubey Rohit	BA LLB	Indore
3	Mr. Dubey Amit	LLB	Indore
4	Mr. Sawant Sameer Tukaram	CS	Mumbai
5	Mr. Naik Ajay Ashok	CS	Mumbai
6	Mr. Vig Kartik Rupin	BMS LLB 2nd Yr.	Mumbai

I. PAST PROGRAMMES

1. IT CONNECT COMMITTEE

Seminar on "GST Returns: Provisions, Process & Software Options" was held on 8th August, 2017 at K. C. College. The seminar was addressed by CA. Parag Mehta and CA Mitesh Katira. The seminar was well attended by more than 300 participants.

2. LAW & REPRESENTATION COMMITTEE

REPRESENTATIONS

A) Representation on Extension of due date of Filing Return of Income in certain cases before Mr. Sushil Chandra, Chairman, Central Board of Direct Taxes and Dr. Hasmukh Adhia, Revenue Secretary Ministry of Finance was made on 30th July, 2017. Pursuant to the representation the CBDT has extended the due date of filing the Returns of Income from 31st July, 2017 to 5th August, 2017.

B) Representation on Relaxation from Linking of Aadhaar Number for Private Trusts Filing Returns as "Individual" before Mr. Sushil Chandra, Chairman, Central Board of Direct Taxes and Dr. Hasmukh Adhia, Revenue Secretary, Ministry of Finance on 24th July, 2017.

II. FUTURE PROGRAMMES

(For details of the Future Programmes, kindly visit www.ctconline.org or refer The CTC News of August, 2017)

Study Circle & Study Group Committee

Study Circle on Recent Judgments under Direct Taxes held on 18th July 2017 at SNDT Committee Room

Dignitaries on dais. Seen from L to R: CA Mahendra Sanghvi (Past President), CA Dilip Sanghvi (Vice Chairman), Mr. Nishit Gandhi – Advocate, Mr. Ajay R. Singh, Advocate (President), CA Pradip Kapasi (Speaker), CA Ashok Sharma (Chairman) and CA Dinesh Shah (Convenor)

CA Pradip Kapasi (Speaker) addressing the participants

Direct Taxes Committee

Webinar on Income Tax Amendments & Return Filing for AY 2017-18 – Provisions and Issues held on 15th July 2017

CA Mahendra Sanghvi (Speaker) addressing the participants

Indirect Taxes Committee

Indirect Tax Study Circle on Issues Regarding Transitional Provisions under GST held on 25th July 2017 at SNDT Committee Room

CA Shrenik Shah (Speaker) addressing the participants

Mr. Vinod Avtani, Advocate (Chairman) addressing the participants

Webinar on RCM, Tax Invoice and Documentation held on 3rd August 2017

CA Ashit Shah (Speaker) addressing the participants

International Taxation Committee

FEMA Study Circle on FDI & ODI by NRI held on 2nd August 2017 at CTC Conference Room

CA Vishal Shah (Speaker) addressing the participants

CA Natwar Thakrar (Chairman) addressing the participants

IT Connect Committee

Seminar on GST Returns: Provisions, Process & Software Options held on 8th August 2017 at K. C. College

Mr. Ajay R. Singh, Advocate (President) giving opening remarks

CA Dinesh Tejwani (Chairman) welcoming the speakers

Dignitaries on the Dias. Seen from L to R – CA Uday Shah (Convenor), Mr. Ajay R. Singh, Advocate (President), CA Parag Mehta (Speaker) and CA Dinesh Tejwani (Chairman)

CA Parag Mehta (Speaker) addressing the participants

CA Mitesh Katira (Speaker) addressing the poarticipants.

Dignitaries

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