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The Chamber of Tax Consultants

Vol. VI | No. 2 November 2017

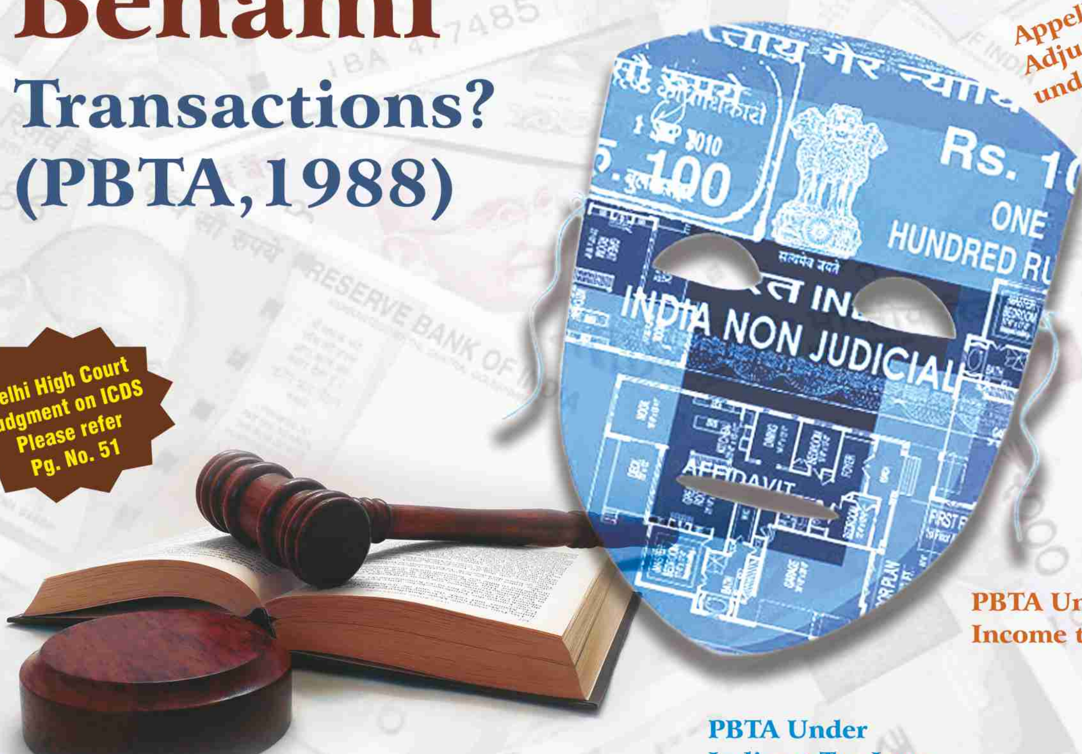
THE CHAMBER'S JOURNAL

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

End of Benami Transactions? (PBTA,1988)

Benami Property – Benamidar and Beneficial Owner

Appellate & Adjudication under PBTA



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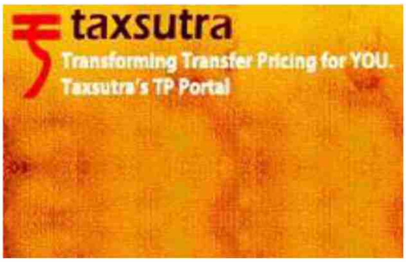

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The Chamber's Journal

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

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Editorial

At the outset, I congratulate the President and his team who filed the W.P. (C) 5595/2017 before the Hon'ble Delhi High Court challenging the validity of Notification No. 087/2016 dated 29th September, 2016 through which the Central Government notified ten '*Income Computation and Disclosure Standards (ICDS). The Hon'ble Court has struck down certain parts of the notification. The Hon'ble Court in Para 42 of the order observed that "only a competent legislature that can make a validation law to override judicial precedents and that too by actually removing the defect pointed out by such precedent. Such a power is not available to the executive. In other words, where there is a binding judicial precedent, by virtue of Articles 141 and 144 of the Constitution, it is not open to the executive to override it unless there is an amendment to the Act by way of a validation law."*

For the sake of the subscribers of The Chamber's Journal, we are analysing the above decision under our feature 'Hot Spot.'

One year after the Indian economy received its shock treatment by way of demonetisation, it is showing signs of recovery. The debate whether demonetisation was a right or wrong step should be left to the economists. Here, I would like to refer to one historic fact. Nawab Siraj-ud-Daulah was brought down on 23rd June, 1757 by the East India Company as he was acting against the corrupt and corruption. The East India Company led by Robert Clive bribed Mir Jaffar to cheat Siraj-ud-Daulah. This led to Siraj-ud-Daulah's defeat in Battle of Plassey on 23rd June, 1757. This loss of an Indian ruler was significant as thereafter, East India Company controlled the entire South Asia. It is very important to note that the East India Company or British Rule established itself in this country through means of corruption. This deep routed malice of corruption has to be treated. So it is too early to say whether demonetisation was an effective tool or measure sufficient to deal with this. At least an effort is made by this Government to deal with corruption. The decision to put life into the still born child known as "Prohibition of Benami Transactions Act, 1988" shows that they have got intentions to move in the right direction. In view of this, the Journal Committee of The Chamber of Tax Consultants has decided to dedicate the special story for this month to the Benami Transactions Act. In this special story, eminent professionals have covered amendments made in the year 2016.

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

K. GOPAL
Editor

From the President

Namaskaar,

I am pleased to inform you that our association had filed a writ petition before the Delhi High Court challenging the Constitutional validity of the ICDS. The Hon. High Court *vide* order dated 8-11-2017 pronounced its judgment holding that ICDS is not meant to overrule the provisions of the Act and the judicial precedent applicable thereto. Thus the court has struck down the ICDS provisions that went against judicial pronouncements and the Act. The Chamber has once again taken the cause of professionals before the Hon'ble Court. Chamber has proved to be the voice of the tax professionals .It is a proud moment for our members

India for the first time moved into the top 100 in the World Bank's Ease of Doing Business global rankings on the back of sustained business reforms over the past several years. Indicating that the country is continuing its steady shift towards best practice in business regulation. As per report while there has been substantial progress, India still lags in areas such as Starting a Business, Enforcing Contracts, and Dealing with Construction Permits. There are several areas where there is considerable scope for improvement. Prominent among them being:

A. Legal system needs reforms – More Judges/ law officers – more court rooms – speedy trial – digitalisation of all lower courts. Special courts to try offences relating to economic crime – Today cost of litigation is very high a poor person cannot afford to reach the High Court or Supreme Court due to cost involved.

B. Certainty in law – There is too much legislation but very less implementation. Business model are set up based on the existing laws and its interpretation, if laws are changed frequently there is always an uncertainty in business deal. Today the Government is extending the dates for filing IT & GST returns, giving waivers for penalty, postponing some provisions in GST. Though the suggestions were made earlier by various stakeholders but no heed was paid to them. However a welcome move by Government in relaxing the GST provisions.

C. Enforcement of contracts – There is need to have more commercial courts; parties should be adhering to their commitments and that is possible only if enforcement of contract is effective.

D. Starting a business – Today also starting a business is a nightmare, one just doesn't know how many applications/ registrations are required, one window system is need of the hour for starting any business.

E. Construction permits – Real estate is one sector which needs an over hauling. Litigation, corruption, black money etc. is attached to this sector. RERA is in place how effective it will be, would be proved in times to come.

F. Accountability – Someone should be accountable and take responsibility for the act. The recent stampede at station or the open manhole incident etc shows how easy it is for babus to go scot free. Nobody takes responsibility and people forget and accept such incidents as part of their daily routine.

G. Banking reforms: Banking system needs to be robust. Banking should expand specially in rural sectors.

One year later after demo, one can see the changes in economy. The amount of cash that's being circulated in the economy is lower than it was pre-demonetisation. The PM fought the elections with corruption and black money as the main issue. So, it was important for him to take such a decision. From the country's perspective, it was a major move in the fight against black money.

The 4 day GST orientation course organised by the IDT Committee was very well attended. The panel discussion of three experts for 4 hours was icing on the cake.

The Special Story for this month is on "Prohibition of Benami Transactions Act-1988 (PBTA) - As Amended by the Benami Transaction Prohibition (Amendment) Act, 2016". I thank all the authors for sparing valuable time and for their contribution to the Chamber's Journal for this month.

Jai Hind !

AJAY R. SINGH
President

Chairman's Communication

Dear Readers,

It seems so recent that the Prime Minister Narendra Modi announced demonetisation of ₹ 500 and ₹ 1000 notes on 8th November 2016. While the Government celebrates first anniversary of demonetisation, debate on disruption of economy due to demonetisation vis-a-vis benefit thereof continues. There is a section of people who strongly feels that demonetisation will reap huge benefits in next few years whereas there are others who feel that it has harmed the economy and impeded growth. Two of the main objectives of demonetisation were to stop generation of black money and corruption. Has it really happened?

There has certainly been slowdown in the economy due to which the Economic Advisory Council to the Prime Minister has identified 10 priority areas for reviving growth and employment in the next six months. Followed by this, the Government very recently also unveiled package of measures to accelerate the economic growth. These are recapitalisation package of ₹ 2.11 trillion for the public sector banks to fix their bad loan problem and investment of ₹ 6.92 trillion for construction of 8367 kms. of roads. Let us hope that something positive would emerge out of these measures by the Government

The Government appears to be determined to continue to pursue economic reforms, be it enactment of new law, GST, FDI policy etc. despite the criticism it got from all corners, the result is for everyone to see! India broke into top 100 in the World Bank's Ease of Doing Business rankings, notching up the biggest improvement among all countries. The rise to the 100th position from 130th last year made India one of the top 10 best improved countries. Indeed a matter of pride for all of us ! Let us hope that the Narendra Modi Government achieves the target of breaking into the top 50 !

It is always the endeavour of the committee to bring out special stories on subjects which are relevant and of practical use to the members. Considering this , the current issue is on a very important topic of The Benami Transactions (Prohibition) Amendment Act, 2016. The Act has been amended significantly, widening its scope to discourage the practice of benami transactions and tax evasion. The issue would not have been possible without the efforts of my colleague CA Paresh Vakharia and CA Sanjeev Lalan who have very well designed the issue covering all the important aspects. My sincere thanks and appreciation to both of them as well as convenor, CA Bhavik Shah 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

The Chamber of Tax Consultants

Vision Statement

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

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

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

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

Dr. Dilip K. Sheth, FCA LLM Ph. D (Law)

Prohibition of Benami Property Transactions Act, 1988 – An Introduction

1. Legislative Background

The name of the predecessor Act was *"Benami Transactions (Prohibition) Act, 1988"*. That name was substituted with the captioned name by the *Benami Transactions (Prohibition) Amendment Act, 2016* with effect from 1st November 2016.

The evolution of Benami Law commenced in 1988 with the promulgation of the Benami Transaction *(Prohibition of the Right to Recover (Property) Ordinance, 1988* on 19th May, 1988. It is imperative to know the background preceding the 1988 Ordinance.

1.1 Pre-Partition Period

In earlier decades of pre-partition period, benami transactions were common. In that period, the same were not considered inherently wrong because, within their legitimate scope, the same accorded with the customs and habits then prevalent. As early as in 1915, the Privy Council spoke of benami transactions as *"quite unobjectionable"* and as having their analogues in English Law. Indeed, such benevolent observations excluded fraudulent transactions and transactions for fraudulent or illegal purpose.

Even under the current law, section 5 of the *Transfer of Property Act* does not consider that a benami transaction, in itself, is illegal because *"transfer of property"* as defined in section 5 of that Act does not exclude the transfer and registration of property in the name of a person other than the real owner.

1.2 Pitfalls of Benami System

With passage of time, however, it was realised that all benami transactions were not harmless. Thus, benami transactions were resorted to for furthering illegal, fraudulent or questionable objects, such as, tax evasion. Often, claims of creditors were sought to be defeated by the real owner by transfer of property to others.

Recognition of benami transactions as a part of legal system also created legal and factual controversies. Such controversies often led to complex litigation with uncertain consequences. The Law Commission in its 57th report, noted[1] that the law permitting and recognising benami transactions resulted in wasteful litigation and enabled all sorts of frauds to be committed. Day in and day out, suits were filed after years of transaction challenging, say, the alienation by father as being not for legal necessity. Similarly, long after a transaction was completed and money received, someone raised his head to

1 See Paragraph 6.21 of the 57th Report of the Law Commission: August, 1973

claim that he was the owner and often the notice of such title was falsely alleged.

1.3 Need for Legal Reforms

Having regard to such downside of benami transactions, the Law Commission recommended that the law pertaining to benami transactions be reformed to reduce wasteful litigation and leave courts free to do fruitful work. Keeping in mind such recommendation of Law Commission, statutory modifications were incorporated in Section 66 of the Civil Procedure Code and Section 281A of the Income-tax Act.

Whether such modifications were sufficient to tackle ill-effects of benami transactions was a question that continued to haunt Government. Accordingly, from time to time, Government critically reviewed the relevant provisions.

2. Scenario Prior to Enactment of Benami Transactions (Prohibition) Act, 1988

2.1 Law Commission: 57th Report: August 1973

In August 1970, while considering the Taxation Laws (Amendment) Bill, 1969, the Select Committee adverted to various aspects of benami law.

In its journey to tackle the problem of benami transactions, the Government made a reference way back in December, 1972 to the Law Commission to consider the proposal of absolute prohibition of benami transactions. The Law Commission submitted its 57th report on benami transactions on 7th August, 1973.

2.2 Benami Ordinance, 1988

After passage of almost fifteen years, the Government promulgated the *Benami Transaction (Prohibition of Right to Recover Property) Ordinance, 1988* on 19th May, 1988 to enact section 4. This section introduced the prohibition on the right of the real owner to recover benami property from benamidar. Government also repealed section 66 of the *Code of Civil Procedure,* Section 281A of the *Income-tax Act* and certain provisions of the *Indian Trusts Act.*

In July 1988, the Law Ministry called upon the Law Commission to examine the *1988 Ordinance* in detail to enable Government to draft appropriate law to deal with benami transactions.

2.3 Law Commission's 130th Report: August 1988

The Commission critically reviewed various ramifications of the 1988 Ordinance and gave its 130th Report on 14th August, 1988. This report was a continuum of 57th Report of the Law Commission. Divided into five detailed chapters, this 130th report outlined glaring lacunae in the Ordinance and suggested appropriate remedial steps.

2.4 Benami Transactions (Prohibition) Act, 1988

On the basis of 130th report of the Law Commission, Government eventually enacted the *Benami Transactions (Prohibition) Act, 1988* on 19th May, 1988.

3. Broad Contours of 2016 Amendment in 1988 Act

3.1 Change in the name of the Act and its structure

When enacted in 1988, the *Benami Transactions (Prohibition) Act, 1988* ("the old Act") had only nine sections. The *Benami Transactions (Prohibition) Amendment Act, 2016* ("the Amendment Act") amended the old Act. A broad review of the Amendment Act showed that it made following changes.

– It enlarged the old Act from nine sections to seventy-two sections.

– It also rechristened the old Act as "The Prohibition of Benami Property Transactions Act, 1988". The Amended Act came into force on 1st November, 2016.

3.2 Continuation of 1988 Act by enlarging its original size eight times rather than enacting a new law – Rationale underlying

The moot point for consideration is: what was the rationale for not enacting a new Act but continuing the old Act by enlarging it almost eight times? The Finance Minister has explained the rationale in the following words[2]:

> "… … The reason why the Standing Committee said that we need a new Bill is that the original 1988 Bill was a small Bill with nine sections. It provided for acquisition of a property. Now when you acquire, you pay compensation. In any acquisition law, compensation is to be paid. There was no vesting of that property in the Government. It was an acquisition in favour of the Government. Then, the entire procedure, the principles of compensation, the authorities for acquisition and implementing all was absent in that Bill.
>
> The Law Ministry took a view that the basic principles of the Bill, if all this to be done by the rules, would be ultra vires because this would be a case of excessive delegation, and therefore, the rules cannot be framed. From 1988 till today 2016, the rules have not been framed. One of the Hon'ble Members wanted to know whether any properties have been actually acquired. The answer is 'no' because the machinery for enforcement itself was not created, though there are two judgments of the Supreme Court which interpret this Act in order to tell us as to what is Benami and what is not *Benami*.
>
> The 1988 Act also has a provision for prosecution. The provision for prosecution, prohibition and acquisition remained in that Act. So, the prosecution provision under section 3(3) says that whoever enters into any benami transaction shall be punishable with imprisonment for a term which may extend to three years or with fine or both. So, whoever subsequent to 1988 entered into a transaction which was a benami transaction, either of the two parties would be liable for prosecution.
>
> So, <u>if we had</u> accepted the recommendation of the Standing Committee – <u>repealed the 1988 Act and recreated a new law in 2016 – that would have been granting immunity to all people who acquired properties benami between 1988 and 2016</u>. Obviously, the acquisition now cannot take place, but the penal provisions of the 1988 Act also would have stood repealed. When a new Act with a similar provision would have come, it could only apply for a penal provision to properties which are benami and entered into after 2016.
>
> Anybody will know that a law can be made retrospective, but under Article 20 of the Constitution of India, penal laws cannot be made retrospective. The simple answer to the question <u>why we did not bring a new law is that a new law would have meant giving immunity to everybody from the penal provisions during the period 1988 to 2016 and giving a 28-year immunity would not have been in larger public interest, particularly if large amounts of unaccounted and black money have been used to transact those transactions</u>. That was the principal object. Therefore, prima facie the argument looks attractive that 'there is a 9-sections law and you are inserting 71 sections into it. So, you bring a new law.', but a new law would have had consequences which would have been detrimental to public interest." [Emphasis supplied]

2 See: The debate on the Amendment Bill in Lok Sabha on 27-7-2016.

It may be noted that the Supreme Court has approved[3] the reference to the discussion and debates of Parliament and Parliamentary Committees Reports as an external aid for construction of an enactment. These reports and debates give a view of the discussion that transpired during the Parliament and Committee proceedings.

4. Effective date ofthe Actcoming into force – Retroactive operation

4.1 Coming into force

Section 1(3) provides the coming into force of the following provisions.

- The following three sections shall come into force at once (i.e. on 5th September, 1988 when the Act received the assent of the President).
  - Section 3: Prohibition of benami transactions
  - Section 5: Property held benami liable to acquisition

    ("acquisition" substituted by "confiscation" w.e.f. 1st November 2016)
  - Section 8: Composition of Authority
- The other provisions of the Act shall be deemed to have come into force on 19th May, 1988.

As regards the expression "shall come into force", it may be noted that the same seems to be confined only to sections 3, 5 and 8. In respect of the provisions other than the said three sections, the expression used is *"shall be deemed to have come into force"* which is different from *"shall come into force"*. To understand the implications of these two expressions, one needs to consider the settled law on the aspect of "retrospectivity".

4.2 Retrospectivity

It is clear from the wordings of section 1(3) that the provisions of sections 3, 5 and 8 *"shall come into force at once"* (i.e. upon receiving the assent of the President). The assent of the President was received on 5th September, 1988.

Use of the words *"shall be deemed to have come into force on 19th May, 1988"* in section 1(3) in respect of the provisions other than sections 3, 5 and 8 is a clear indication that the Act intended to give retroactive effect to such other provisions.

It has been held by the Supreme Court[4] that when an Act is declaratory in nature, the presumption against its retrospectivity is not applicable.

The provisions other than sections 3, 5 and 8 shall be *"deemed to have come into force"* on 19th May 1988. These two expressions, though different in language, deal with the aspect of retrospectivity.

The issue of retrospectivity has been dealt with by the Supreme Court in the following decisions.

- *Mithilesh Kumari vs. Prem Bihari Khare (1989) 177 ITR 97 (SC)*
- *Narinder Kumar Jain vs. Munisubrat Dass Jain (1990) 181 ITR 305 (SC)*

In *Mithilesh Kumari's case*, it was held by the Supreme Court that a statute for prohibition (i.e. the Benami law) affects all property irrespective of the time or the date of the transaction, and is retroactive. Accordingly, it was further held that when the law nullified the defences available to the real owner for recovering the benami

3 Nayak vs. Antulay AIR 1977 SC 2328

4 Mithilesh Kumari vs. Prem Behari Khare (1989) 177 ITR 97 (SC) distinguishing Nand Kishore Marwah vs. Samundri Devi: AIR 1987 SC 2284; (1987) 4 SCC 382; Rajagopal Reddy vs. Padmini Chandrasekharan (1995) 213 ITR 340 (SC)

property from the benamidar, the law applied irrespective of the time of the transaction. Mithilesh Kumari's decision (infra) was followed by the Supreme Court in a later decision in *Narinder Kumar Jain's case* (infra). Thereafter, in *Gangacharan case (2000) 242 ITR 126 (SC)*, it was held that neither the Benami Transactions *(Prohibition of the Right to Recover Property)* Ordinance, 1988 nor the Act which replaced it are retrospective in operation.

However, subsequently, in R. Rajagopal Reddy v Padmini Chandrasekharan (1995) 213 ITR 340 (SC) and C. Gangacharan vs. C. Narayanan (2000) 242 ITR 126 (SC): (2000) 1 SCC 459: AIR 2000 SC 589, the Supreme Court dealt with this aspect. In Rajagopal Reddy case Mithilesh Kumari's decision was dealt with in the following manner.

- *approved the decision in Mithilesh Kumari's case,* (infra), by observing to the effect that section 3(1) creates a new offence of entering into benami transactions. It is made non-cognizable ... ... It is therefore obvious that when a statutory provision creates a new liability, it would naturally have prospective operation and would cover only those offences which take place after section 3(1) comes into operation[5].
- *overruled Mithilesh Kumari's case* (infra) by holding that:
  - the Division Bench erred into taking the view that section 4(1) of the Act could be pressed in service in connection with suits filed prior to coming into operation of that section.
  - similarly, the view that under section 4(2), in all suits filed by persons in whose names properties are held, no defence can be allowed at any future stage of the proceedings, that the properties are held benami, cannot be sustained.

5. Limitations of the Pre-amended Act

The pre-amended Act lacked strength as regards the enforcement of its provisions. The principal limitations of the pre-amended Act were, as follows.

- Legitimate exceptions to the definition of benami transaction in specific cases, were not defined.
- There was no specific provision for vesting of the confiscated property in the Government.
- Though the jurisdiction of civil court was barred, the Act did not provide for appellate remedy against the action of the authorities.
- For implementation of its provisions, the Act did not give the powers of a civil court to the authorities entrusted with implementation of its provisions.

6. Amendments made by the Benami Transaction Prohibition (Amendment) Act, 2016

With the view to address the ill-effects of the limitations of the pre-amended Act, the Benami Transaction Prohibition (Amendment) Act, 2016 made several changes in the Benami Property (Prohibition) Act, 1988. The gist of important changes is reviewed here.

- The Amendment Act has incorporated four exceptions to the 'benami transaction' to meet the legitimate needs of the following entities and persons.
  - Karta of HUF
  - Executors of a Will

5 See also: Pawan Kumar Gupta vs. Rochiram Nagdeo (1999) 4 SCC 243: AIR 1999 SC 1823

- Trustees of a trust
- Partners of a partnership firm
- Director of a company
- Spouse, child, brother or sister
- Lineal ascendants and descendants

• The Amendment Act has expanded the definition of "property" so as to include the following items in the said definition.

- Corporeal or incorporeal property
- Any rights, interest or legal documents or instruments evidencing title to or interest in the property
- Property in converted form
- Sale proceeds of the property

• For effective implementation and enforcement of the provisions of the Act, comprehensive set of authorities, their composition, their jurisdiction and powers are now clearly set out.

• The authorities under the Act have been vested with the powers of a civil court while trying a suit, such as, discovery and inspection, enforcing attendance, examining on oath, production of evidence, books and documents, receiving evidence on affidavits, etc.

• In the enforcement of the provisions of this Act, assistance of officers of the other agencies has been provided, such as, Income-tax Officers, Customs officers, officers of Stock Exchange, SEBI and Enforcement Directorate, etc.

• Rules have been framed to carry out the various purposes of the Act, such as, for acquisition of benami properties, attachment, adjudication, etc.

• Provisional attachment of property is now made possible.

• Appellate Tribunal has been established with appropriate powers for its effective functioning.

• Penalties by way of imprisonment and fine have been provided for benami transaction entered into for nefarious purposes, such as, tax evasion, defeating provisions of any law and avoiding claims of creditors.

• Special Courts have been established for taking cognizance of offence under this Act to which criminal law has been made applicable.

7. General

The Amendment Act has comprehensively set out a mechanism for detection and investigation and also for effective and speedy dispute resolution and prosecution.

The constitution of the Appellate Tribunals is intended to add to the speed of dispute resolution. One may compare this to the overburdened civil courts which are bound by the rules of the Civil Procedure Code. It is normal for a suit to take several years to reach conclusion.

By setting up Special Courts to exclusively look after matters under this Act, the speed of disposal of criminal trials will be improved.

Dr. Anup P. Shah, *Chartered Accountant*

Benami Property – Benamidar and Beneficial Owner

Introduction

A Benami Transaction is a transaction in which the property is acquired by one person in the name of another person or a business may be carried on by some person in the name of another person. Thus, the real or beneficial owner remains unknown and the apparent owner is only a name lender. *As the word 'benami" suggests it is one without a name.* This practice of benami transactions has been extremely prevalent in India for several years. Benami transactions are one of the main sources of utilisation of black money, tax and duty evasion, corruption, etc. Benami transactions are quite common in the real estate business. However, they have also entered the arena of the stock market and other areas. Benami transactions were also used as a device for asset protection as the creditors would never be able to get their hands on a property which did not legally belong to their debtor. To deal with and curb benami transactions, the **Benami Transactions (Prohibition) Act, 1988 ("the Act")** was passed. However, this law suffered from various inadequacies. Accordingly, the ***Benami Transactions (Prohibition) Amendment Act, 2016 ("the Amendment Act")*** was notified in the Official Gazette on 11th August, 2016 which substantially amended the Act. One important feature of the Amendment Act is that it empowers the Government to frame Rules something which the original Act did not have. Let us examine some important facets of this Act.

Overlap with PMLA

The Finance Ministry has clarified that objectives of the Prevention of Money Laundering Act, 2002 and the Benami Transactions Act are not the same. PMLA deals with money laundering which involves disguising financial assets so that they can be used without detection of the illegal activity that produced them. Thus, PMLA is restricted only to proceeds of crime, i.e. property obtained as a result of criminal activity relating to scheduled offences. The Benami Act operates on a different plane. It is not only restricted to proceeds of crime because its objective is to prohibit a benami transaction so that the beneficial owner would be compelled to keep the property in his own name only and the legal complexities owing to the apparent ownership not being the real ownership, could be avoided. The prohibition would apply irrespective of the nature or source of the funds invested in the property. Thus, the Benami law applies equally to both a property acquired through proceeds of crime and a property acquired through legitimate means and hence its scope is wider than PMLA. Though, a benami transaction could be used to disguise the real ownership of a property to prevent detection of the illegal activity that produced it, but that may not always be the case. This is because a benami transaction could be entered into for several other purposes also like defrauding creditors, avoiding payment of taxes or social reasons. In view of the above, the Benami Act was proposed as a separate legislation and not as a part of the PMLA. Further, except for the common institutional set up for adjudication and appeal, there is no overlap with the provisions of the law regarding money laundering and hence there is no scope of any confusion in this regard.

Definitions

Some of the Key definitions under the Amendment Act are analysed below.

Benami Transaction/Benamidar/ Beneficial Owner

A Benami Transaction had been defined under the Act to mean a transaction in which the property is transferred to one person for a consideration paid or provided by another person. Thus, in a benami transaction, there are two persons, the ***Beneficial Owner***, i.e., the real owner who actually should be owning the property but the property does not stand in such person's name; the second person is the one in whose name the property stands who is nothing but a mere front, i.e., the **Benamidar**. The term "**Benami**" in effect means one which has no name. Thus, the definition of a benami transaction as contained under the Act (prior to amendment) may be summarised as under:

It is a transaction

(i) in which a property is bought by one person and transferred to another person; or

(ii) in which the property is directly bought by one person in the name of another person

The Amendment Act seeks to considerably enhance the definition of a benami transaction. The modified definition reads as under:

(A) a transaction or an arrangement-

  (i) where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and

  (ii) the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration;

This is the most crucial part of the definition. Two limbs must be satisfied in order to constitute a transaction or an arrangement as a benami transaction – the property held by one has been paid for by another and the property so held is held for the benefit of that other who provided the consideration. Hence, the added angle of property being held for the benefit of the provider of the consideration has also been added to the definition. For instance consider a property purchased by Mr. A on a loan basis where the loan has been directly provided to the vendor by Mr. X. In this case, the first part of the definition is satisfied, i.e., property held by one (Mr. A) where consideration has been provided for by another (Mr. X). However, the second part of the definition is not satisfied, i.e., the property so held by Mr. A is not held for the benefit of that other (Mr. X) who provided the consideration!

The rationale for this additional condition added by the Amendment Act was explained by the Finance Ministry. It stated that from the stand point of the transferor, it was wholly immaterial as to from where the consideration came from. The transferor was concerned with the payment of consideration for the transfer and once it was received by him from and on behalf of the transferee, in reality or ostensibly he would have no regard for any other matter. The circumstances in which another person paid or provided the consideration to the transferee for being passed on to the transferor may be manifold. A person might have provided consideration money to the transferee out of charity or under some jural relationship such as creditor and debtor or the like. The final relationship between such other person and the transferee had nothing to do or may have nothing to do with the jural relationship between the transferor and transferee. The intention of the other person paying or providing the consideration was in substance the main factor to be considered and was of great importance. If that other person really intended that he should be the real owner of the property, then only the transferee may be characterised as a benamidar, whether the transferee was a fictitious person or a real person having no intention to acquire any title by means of the transfer. The actual payment or provision of consideration had been made the dominant factor, but by itself it may have no real substance unless the person providing the consideration did so with the intention of actually benefiting himself. In view of the above, it was proposed that the payment alone by the other person should not be the only consideration for deciding a benami transaction rather intention of the other person paying or providing the consideration should be considered for deciding a benami transaction. Therefore, to hold a transaction or an arrangement as benami, it was proposed to provide an additional test that the benamidar should be holding the property for the benefit of the person providing the consideration.

(B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name; or

(C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies the knowledge of, such ownership;

(D) a transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious.

Thus, even a transaction wherein the real owner is not aware of ownership has been added. Further, in cases where the consideration provider is untraceable or fictitious would also qualify as a benami transaction.

The term Benamidar has been defined as a person/fictitious person in whose name the benami property is transferred or held and includes a person who lends his name. A Beneficial Owner on the other hand has been defined as a person, whether his identity is known or not, for whose benefit the benami property is held by a benamidar.

It is also relevant to note that this Act does not deal with valuation of properties. Valuation is dealt with by the Income Tax law, e.g., s.56(2)(x) / s.50C / s.43CA / s.50CA, etc. If a person undervalues a property, it is dealt with by the Income Tax Act. So, whether it is adequately valued or inadequately valued is a legitimate subject-matter of the Income-tax Act and not the Benami Act.

The Finance Minister while moving the Amendment Bill has stated that if only a part of property is benami then only that part would be treated as benami property and that part of the property which is not benami will not be acquired. For example, if there is a 20-storeyed building of which 10 Floors are held benami, then the ones which are benami will be acquired.

Not treated as Benami Transactions

The Amendment Act also seeks to carve out certain exceptions/exemptions to the definition of a benami transaction:

(i) Property held by a Karta, or a member of an HUF on behalf of the HUF where the consideration for such property has been paid by the HUF out of its known sources. What is known sources has not been defined under the Amendment Act but it should signify that the source of funds is identifiable. Interestingly, the Benami Transactions (Prohibition) Amendment Bill contained the phrase known sources of income. This was omitted when the Bill was passed. Hence, now consideration paid from a loan/gift would make it a known source and it is not necessary that the consideration must be from the income of the Karta.

(ii) Property held by a person standing in a fiduciary capacity for the benefit of another person towards whom he stands in such capacity and includes a trustee, executor, partner, director of a company, a depository or a depository participant and any other person as may be notified by the Central Government for this purpose. Here it is not necessary that the consideration must be paid from the known sources. For instance, if land is purchased by a partnership firm but the registration is done in the names of the partners then the same would not be treated as a benami transaction. Similarly, a car purchased by a company but registered in the name of the Director to claim depreciation would not be treated as a benami transaction on account of this exemption. Further, the list of six fiduciary relationships are not exhaustive and could include other types of relations also. **P. Ramanatha Aiyar's Concise Law Dictionary, 4th Edition** states that *one acts in a fiduciary capacity* when the property he receives is not his own or for his own benefit but for the benefit of another person to whom he stands in a relation implying and necessitating great confidence, trust and high degree of faith. The term also includes, an attorney, guardian, broker, etc.

(iii) Property held by an individual in the name of his spouse/his child and the consideration for such property has been paid by the individual out of his known sources. Child for this purpose would include a step-child as well as an adopted child.

(iv) Property held by any person in the name of his brother or sister or lineal ascendant or descendant, where the names of such relative and the individual appear as joint-owners, and the consideration for such property has been paid by the individual out of his known sources. Lineal ascendant/descendant would mean relatives in a lineal (direct straight line) ascendancy or descendancy. For instance, a grandfather, father and son would constitute a lineal relationship. Similarly, a grandmother, mother and daughter would constitute a lineal relationship. It is not necessary that lineal descendants/ascendants are limited to male relationships alone – **Dhannalal Devilal, AIR 1956 Raj 30.** All female or combination of male-female relations can also constitute a lineal relationship as long as they are in a straight line. It is important to note that only in this case is it necessary that the property should be held jointly in the names of the purchaser of the property and the sibling or lineal relative. In all other exemption cases, the requirement of joint ownership is not required. Hence, if a person is desirous of buying a property for his relative, he may now consider three alternatives – paying for the property but buying it in his relative's name; gifting money to his relative and the relative buying the property in his name with this money or buying the property himself and then gifting the property itself to his relative. While deciding on which alternative to select, three factors would have to be borne in mind – the applicability of the Benami Law, the applicability of section 56(2)(x) of the Income-tax Act on receipt of gifts by the donee and the stamp duty on such gifts.

(v) Property the possession of which has been obtained in part performance of a contract referred to in section 53 of the Transfer of Property Act, 1882 provided the contract has been duly stamped and registered and consideration for such property has been provided by the possessor of the property while ownership continues with owner. The Registration Act, 1908 and the Transfer of Property Act, 1882 now provide that a contract for part performance u/s. 53A would not be valid unless it is registered. The recent decision of the Supreme Court in the case of *CIT vs. Balbir Singh Maini, CA 15619/2017 (SC)* is also to the same effect. The Finance Minister while moving the Amendment Bill has stated that this exception will enable all properties held by virtue of power of attorney transactions to be excluded from being a benami property. This is a popular route of owning real estate in Northern India. However, it may be noted that the Supreme Court in *Suraj Lamp & Industries P. Ltd. vs. State of Haryana (2012) 1 SCC 656* has clarified that a power of attorney cannot transfer title of an immovable property to the grantee. Nevertheless, such properties would not be benami properties.

Property

The definition of property has been expanded by the Amendment Act and is now defined to mean, property of any kind:

(a) Whether movable or immovable,

(b) Whether tangible or intangible,

(c) Including any right or interest or legal documents evidencing title or interest in such property.

It also includes proceeds from the property. Interestingly, the Act only gives some inclusions to the term property but does not specifically define it. One may refer to some judgments which have dealt with this definition which is very crucial to the Act. The Supreme Court in the celebrated *"Bank Nationalisation case"* of *RC Cooper vs. Union of India, 40 Comp. Cases 325 (SC)* has described property to mean the highest right a man can have to anything, being the right which one has to lands or tenements, goods or chattels which does not depend upon another's courtesy. It includes ownership, estates and interest in corporate things. It signifies a beneficial right to or a thing considered as having a money value, especially with reference to transfer and succession and to their capacity of being injured. Again in *Ahmed G. H. Arif vs. CIT, 76 ITR 471 (SC)* the Apex Court has held that "property" was a term of the widest import and subject to any limitation which the context may require, it signified every possible interest which a person could clearly hold or enjoy. There was no reason why that word should not be given a liberal and wide connotation and should not be extended to those well recognised types of interests which had the insignia or characteristics of proprietary right.

The Finance Minister while moving the Amendment Bill had stated that if an asset is outside the country, it would not be covered under this Act. It would be covered under the Black Money Law. However, the definition of property does not use limit it only to Indian property.

Benami property

This is a new definition and is defined to mean any property which is the subject-matter of a benami transaction and includes proceeds from such property.

Prohibition of Benami Transactions

S.3 is the operative section of the Act. It provides that no person shall enter into any benami transactions. The Act originally provided that a benami offence would be bailable and non-cognizable. This has now been deleted by the Amendment Act. Hence, now the offence would be cognizable but non-bailable. The section provides that whoever enters into any benami transaction on and after 1st November, 2016 would be punished u/s. 53.

S.53 provides that if any person enters into a benami transaction in order to defeat the provisions of any law or to avoid payment of statutory dues or to avoid payment to creditors, the beneficial owner, benamidar and any other person who abets or induces any person to enter into the benami transaction, shall be guilty of the offence of a benami transaction. Any person guilty of the offence of benami transaction shall be punishable with rigorous imprisonment for a term which shall not be less than one year, but which may extend to seven years and shall also be liable to fine which may extend to 25% of the fair market value of the property. Thus, in addition to the compulsory acquisition of the property, the Act also provides for a severe penalty.

The penalty for giving false information is punishable with rigorous imprisonment from 6 months to 5 years and fine up to 10% of the fair market value of the property.

In case a company enters into any benami transaction, not only is the property liable to be acquired but the every person who at the time of the contravention was in charge of and responsible for the conduct of the business would be proceeded against and punished.

Consequences of Benami Properties

In case of a benami property, the real owner of the property cannot enforce or maintain any right against the benamidar or any other person. Thus, the real owner or any person on his behalf is prevented from filing any of a suit, claim or action against the namesake owner.

Similarly, the real owner or any person on his behalf cannot take up a defence based on any right in respect of the benami property against the benamidar or any other person.

Confiscation of Benami Properties

All benami properties are liable to be confiscated by the Central Government. For this purpose, the Amendment Act seeks to appoint an Adjudicating Authority and Initiating Officers. The Deputy Commissioner of the Income-tax would be the Initiating Officer. Where the Initiating Officer has, based on material he possesses, reason to believe that any person is a benamidar of a property, he may ask him to show cause why the property should not be treated as benami property. He can also provisionally attach the property for a maximum period of 90 days. He must then draw up a statement of case and refer it to the Adjudicating Authority. The Authority must provide a hearing to the person affected and pass an order either holding the property to be a benami property or holding it not to be a benami property. The Authority has a maximum period of 1 year from the date of reference to pass its order. The affected person can appear before the Authority in person or through his lawyer/CA.

Once an order is passed by the Authority treating a property to be a benami property, it must pass an order confiscating the benami property. An appeal lies against the orders of the Adjudicating Authority to the Appellate Tribunal to be constituted under the Act. An appellant can appear before the Tribunal in person or through his lawyer/CA. The orders of the Appellate Tribunal can be appealed before the High Court.

Once a property is confiscated, the Income-tax Officer would be appointed as the Administrator of such benami property who will take possession of the property and manage it.

The Act provides that if an Initiating Officer has issued a notice seeking to treat a property as benami property, then after the issuance of such a Notice, the subsequent transfer of the property shall be ignored. If the property is subsequently confiscated then the transfer will be deemed to be null and void.

Re-transfer of Benami Property

A benamidar cannot re-transfer the benami property held by him to the beneficial owner or any other person acting on his behalf. If any benami property is re-transferred the transaction of such a benami property shall be deemed to be null and void. However, this does not apply to a re-transfer of benami property initiated pursuant to a declaration made under the ***Income Declaration Scheme, 2016.*** In this respect, s.190 of the Finance Act, 2016 provides that the Benami Act shall not apply in respect of the declaration of the undisclosed asset, if the benamidar transfers such benami property to the declarant who is the real beneficial owner within the period notified by the Central Government, i.e., on or before 30th September, 2017.

Conclusion

This is one more step in the Government's fight against black money. Used effectively, it would become an effective weapon in the Revenue's arsenal. However, as with all things, an overdose would lead to negative returns and this Act should not become a tool for harassment of honest assessees.

Look at the Sky, We are not alone. The whole universe is friendly to us and conspires only to give the best to those who dream and work.

— Dr. A. P. J. Abdul Kalam

Aditya Ajgaonkar, *Advocate*

Appeals and Adjudication under the Prohibition of Benami Property Transactions Act – 1988 – As Amended by the Benami Transaction Prohibition (Amendment) Act of 2016

It is often said that in our country while the laws are robust, the implementation of those laws leaves a lot to be desired. In order that the implementation of The Prohibition of Benami Property Transactions Act, 1988 – as amended by The Benami Transactions (Prohibitions) Amendment Act, 2016 (hereinafter referred to as ' the Act') is done effectively, the statute has purported to put in place a robust and integrated system for the effective administration and the implementation of the provisions of the said Act. In a world where technology and information integration both are happening on a rapid scale, the authorities under the Act can find an array of suitable sources of information at their disposal. The Act gives a wide array of powers to the authorities to effectively conclude investigations, as well as to meet out effective and efficient justice as per the Provisions of the Act.

Authorities Under the Act and their powers

Chapter III of 'the Act' deals with authorities under the said Act. Section 18 provides that for the purposes of the said Act, there shall be four authorities:-

the initiating officer, the approving authority, the administrative authority and the adjudicating authority.

The said authorities, for the purposes of the said Act, are vested with the same power as vested with a civil court under the Code of Civil Procedure, 1908 for the following matters as per Section 19(1):- (a) Discovery and Inspection , b) Enforcing the attendance of any person, including any official of a banking company or a public financial institution or any other intermediary or reporting entity and examining him on oath, (c) compelling production of books of accounts and other documents, d) issuing commissions, (e) receiving evidence on affidavits and (f) as a residual provision, any other matter which may be prescribed. The said powers are very similar to the powers conferred by Section 131 of the Income Tax Act, 1961, onto the authorities mentioned therein. All the persons summoned under Section 19(1) shall, by virtue of Section

19(2), be bound to attend in person or through authorized agents, as any authority under this Act may direct, and shall be bound to say the truth upon any subject respecting which they are examined or to make statements and produce documents as required and every proceeding under Sec. 19(1) and 19(2) shall be deemed to be judicial proceedings within the meaning of Section 193 and Section 228 of the Indian Penal Code. It is of note that Section 193 of the Indian Penal Code provides for punishment for tendering false evidence in any judicial proceedings or for fabrication of false evidence for the purposes of being used in any stage of a judicial proceeding punishable with a fine and also either simple or rigorous imprisonment for a term that may extend to seven years and Section 228 of the Indian Penal Code makes an intentional insult or interruption to a public servant sitting in judicial proceeding an offence which is punishable by a simple imprisonment for a term that may extend to six months, or with a fine that may extend to one thousand rupees, or both. However, despite being vested with the powers of a Civil Court for limited purposes, the Adjudicating Aauthority shall not be bound by the Code of Civil Procedure, 1908 while adjudicating proceedings under this Act, but shall have the power to regulate its own procedure subject to rules of natural justice and other provisions of the Act. The powers of the authorities constituted under the Act are therefore wide ranging and provide for a robust system for the collection of evidence and to ensure that effective justice is dispensed under the Act.

Powers to collect Information and Evidence

A large country like India, especially with a highly federal structure and strong local self government comes with its own set of challenges when it comes to inter agency co-operation. The Act in order to enhance its effectiveness and implementation by itself provides for the various statutory bodies, government agencies and governing bodies to assist the authorities under this Act to carry out their functions effectively. Section 19(4) of the Act also enables any authority under the Act to requisition the service of any police officer or of any officer of the Central Government or State Government or both to assist him for any or for all the purposes as mentioned in Section 19(1) and makes it a duty of every such officer to comply with the requisition or direction. In addition to the same, Section 20 of the Act provides for an exhaustive list of officers to assist the authorities under the Act in its enforcement including but not restricted to officers holding such diverse posts being Income Tax Authorities appointed under Section 117 (1) of the Income Tax Act, the police, officers of stock exchange, officers of any 'body corporate' constituted or established under a Central or State Act as well as officers of the Central Government, State Government, local authorities or banking companies as notified by the Central Government. Section 21 of the Act empowers the initiating officer, the approving authority or the adjudicating authority to require any officer of the Central Government, State Government, Local body or any officer who is responsible for registering and maintaining books of account or other documents containing a record of any transaction relating to any property or any other person to furnish any information in relation to any person, point or matter as in the opinion of the Initiating Officer, the approving authority or the adjudicating authority shall be useful for or relevant for the purposes of this Act and every such officer shall have to furnish the such information to any authority under this Act.

In addition to the above powers, the Act also empowers the authorities in any proceedings under this Act to impound documents subject to reasonable safeguards as built into Section 22 of the Act, if the authority has a reason to believe that any of the books of accounts or other documents are required to be impounded and retained for any inquiry under this Act. The initiating officer, after obtaining prior approval from the approving authority shall have the power to conduct or cause to be conducted any inquiry or investigation in respect of any person, place, property, assets, documents, books of accounts or other documents in respect of any other relevant matters under the Act.

Initiation of Proceedings and Provisional Attachment

Chapter IV of the Act deals with attachment, adjudication and confiscation under the Act. Section 24 provides that where the initiating Officer, on the basis of material in his possession, has reason to believe that any person is a benamidar in respect of a property, he may, after recording reasons in writing, issue a notice as per the provisions of Section 25 to the said person to show cause within such time as may be specified in the notice why the property should not be treated as benami property and a copy of the notice shall also be issued to the beneficial owner if his identity is known. Where the initiating officer is of the opinion that the person in possession of the property held benami may alienate the property during the period specified in the notice, he may, with the previous approval of the approving authority, by order in writing, attach provisionally the property in the manner as may be prescribed, for a period not exceeding ninety days from the date of issue of notice.

The initiating officer, after making such inquires and calling for such reports or evidence as he deems fit and taking into account all relevant materials, shall, within a period of ninety days from the date of issue of notice, if provisional attachment is made, pass an order continuing the provisional attachment of the property with the prior approval of the approving authority, till the passing of the order by the adjudicating authority or revoke the provisional attachment of the property with the prior approval of the approving authority. Where provisional attachment has not been made, the Initiating Officer shall pass an order provisionally attaching the property with the prior approval of the Approving Authority , till the passing of the order by the Adjudicating Aauthority or decide not to attach the property as specified in the notice, with the prior approval of the Approving Authority .

However as a reasonable safeguard against the possible misuse of attachment as a tool for harassment, the Act also provides that where the Initiating Officer passes an order continuing the provisional attachment of the property, he shall, within fifteen days from the date of the attachment, draw up a statement of the case and refer it to the adjudicating authority. On receipt of a reference under sub-section (5) of section 24, the Adjudicating Aauthority shall issue notice, to furnish such documents, particulars or evidence as is considered necessary on a date to be specified therein, on (a) the person specified as a benamidar; (b) any person referred to as the beneficial owner therein or identified as such; (c) any interested party, including a banking company; (d) any person who has made a claim in respect of the property. The adjudicating authority, after considering the reply and making inquiries and calling for evidences or reports as it deems fit and taking all relevant materials into account and providing the benamidar as well as the initiating officer or any other person who claims to be the owner of the property, shall either pass an order holding the property not to be a benami property and revoking the attachment order; or holding the property to be a benami property and confirming the attachment order. Where the Adjudicating Aauthority is satisfied that some part of the properties in respect of which reference has been made to him is benami property, but is not able to specifically identify such part, it shall record a finding to the best of his judgment as to which part of the properties is held benami.

The Act also provides for the provisional attachment of a property, where in the course of proceedings before it the Adjudicating Aauthority has reason to believe that a property, other than a property referred to it by the Initiating Officer is benami property.

The Act also provides for a time bound disposal of references before the Adjudicating Aauthority by providing that no order shall be passed after the expiry of one year from the end of the month in which the reference was received.

Confiscation and Vesting of Benami Property

Where an order is passed holding any property to be a benami property, the Adjudicating Aauthority shall, after giving an opportunity of being heard to the person concerned, make an order confiscating the property held to be a benami property. This confiscation of property shall be made subject to the order passed by the Appellate Tribunal if any appeal is filed before it. However, no such confiscation shall apply to a property held or acquired by a person from the benamidar for adequate consideration, prior to the issue of notice by the Initiating Officer without his having knowledge of the benami transaction. Where an order of confiscation has been made, all the rights and title in such property shall vest absolutely in the Central Government free of all encumbrances and no compensation shall be payable in respect of such confiscation. However if no order of confiscation is made upon the proceedings under this Act attaining finality, no claim shall lie against the Government for any damages.

Management of properties confiscated

The management of the confiscated properties shall be done by the Administrator who shall also be receiver for the said property. Once an order of confiscation is made, the Administrator shall proceed to take possession of the said property. The Act also authorises the Administrator to take the assistance of a police officer if required for the purpose. Once an order of confiscation has obtained finality, the Administrator shall also take measures to dispose of the said property as per the directions of the Central Government and conditions prescribed.

Appellate Tribunal

Chapter V of the Act provides for the establishment and the functioning of the Appellate Tribunal.

The Central Government shall, by notification, establish an Appellate Tribunal consisting of a Chairperson and at least two other Members to hear appeals against the orders of the Adjudicating Aauthority under this Act. Out of the two members, one shall be a Judicial Member while the other shall be an Administrative member and they shall sit with the Chairperson to decide upon the Appeals that lie from the orders of the adjudicating authority. The decisions are to be taken by majority. The Benches of the Appellate Tribunal shall ordinarily sit in Delhi or at any place the Central Government may specify after consultation with the chairperson. The Territorial Jurisdiction of each Bench of the Appellate Tribunal shall also be as notified by the Central Government.

All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code, 1860 and the Appellate Tribunal shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

Like the Adjudicating authority, The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, but shall be guided by the principles of natural justice and shall have powers to regulate its own procedure, subject to the other provisions of this Act. It shall, for the purposes of discharging its functions under this Act, have the same powers as are vested in a civil court under the Code of Civil Procedure, while trying a suit, in respect of the following matters:-(a) summoning and enforcing the attendance of any person and examining him on oath, (b) requiring the discovery and production of documents, (c) receiving evidence on affidavits, (d) Requisitioning any public record or document or copy of such record or document from any office subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, (e) issuing commissions for the examination of witnesses or documents, (f) reviewing its decisions,(g) dismissing a representation for default or deciding it ex parte,(h) setting aside any order of dismissal of any representation for default or any order passed by it ex-parte; and any other matter, which may be, prescribed by the Central Government.

For the purposes of execution of its orders, the Appellate Tribunal shall have all the powers of a civil court as it shall be executable by it as a decree of civil court. However there is no bar upon the Appellate Tribunal from transmitting its order to a civil court having jurisdiction for execution. However, no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which any of the authorities, an Adjudicating Aauthority or the Appellate Tribunal is empowered by or under this Act to determine, and no injunction shall be granted by any court or other forum in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Any person, including the Initiating Officer, aggrieved by an order of the Adjudicating Aauthority may prefer an appeal in such form and along with such fees, as may be prescribed, to the Appellate Tribunal against the order passed by the Adjudicating Aauthority within a period of forty-five days from the date of the order. The Appellate Tribunal has the power to condone delay and therefore may entertain any appeal after the said period of forty-five days, if it is satisfied that the appellant was prevented, by sufficient cause, from filing the appeal in time.

The Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit. The Appellate Tribunal while deciding the appeal shall have the power to determine a case finally, (a) where the evidence on record is sufficient, (b) to take additional evidence or to require any evidence to be taken by the Adjudicating Aauthority where it has wrongly refused to do so, (c) to require any document to be produced or any witness to be examined, (d) to frame issues which appear to the Appellate Tribunal essential for adjudication of the case and refer them to the Adjudicating Aauthority for determination; (e) to pass final order and affirm, vary or reverse an order of adjudication passed by the Adjudicating Aauthority and pass such other order or orders as may be necessary to meet the ends of justice.

For the purpose of expediting justice, the Act provides that the Appellate Tribunal, as far as possible, may hear and finally decide the appeal within a period of one year from the last date of the month in which the appeal is filed. The Appellate Tribunal or the Adjudicating Aauthority may, in order to rectify any mistake apparent on the face of the record, amend any order made by it within a period of one year from the end of the month in which the order was passed and if the amendment is likely to affect any person prejudicially, he shall be given notice of intention to do so and an opportunity of being heard.

Rule 10 of the Benami Properties Transaction Rules as contained in the Notification dated 25th October 2016 lays down the rules to be followed while filing of appeal before the Appellate Tribunal.

Special Courts

The Prosecution under the Prohibition of the Benami Transactions Act are to be done by special courts set up for the purpose as provided by Chapter VI of the Act. Benami transactions by their very nature are often technical and complicated in nature. Moreover, the Indian criminal justice system is already burdened with a large pendency. In order to provide an effective and expedited manner of punishing those guilty in indulging in benami transactions, the Central Government in consultation with the Chief Justice of the High Court, shall for trial of an offence punishable under this Act designate one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or group of cases as may be specified in the notification. However, the Jurisdiction of these Special Courts shall not be within the narrow ambit of only adjudicating upon prosecutions under this Act, but while trying an offence under this Act, a Special Court shall also try an offence other than an offence under this Act with which the accused may be charged at the same trial. Every trial under this section shall be conducted as expeditiously and every endeavour shall be made by the Special Court to conclude the trial within six months from the date of filing of the complaint.

The Special Court shall not take cognizance of any offence punishable under this Act except upon a complaint in writing made by either the authority; or any officer of the Central Government or State Government authorised to do so in writing. The Provisions of the Code of Criminal Procedure, 1973 shall apply to proceedings before the special court unless otherwise provided for by the Act.

Appeal to High Court

Any party aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within a period of sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order. The High Court may entertain any appeal after the said period of sixty days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the period. The High Court shall formulate a substantial question of law if it is satisfied that such a question of law exists and the appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question. However, nothing shall be deemed to take away or abridge the power of the court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. As the High Court shall only decide substantial question of law, hence the Appellate Tribunal can also be construed to be the final fact finding authority for the purposes of proceedings under this Act. However, under the Act, the High Court may determine an issue that has not been determined by the Appellate tribunal or has been wrongly determined by the Appellate Tribunal, by reason of a decision on a substantial question of law framed by it. Unlike the Adjudicating Aauthority and the Appellate Tribunal, the High Court shall be bound by the Rules of Code of Civil Procedure in as far as they pertain to it.

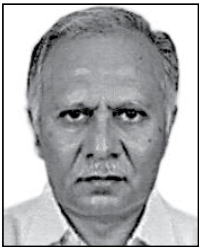
The High Court may exercise, so far as may be applicable, all the powers conferred by Chapter XXIX or Chapter XXX of the Code of Criminal Procedure, 1973, on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court. The High Court therefore not only has powers of reference and revision before the High Court as provided for Chapter XXX (Sections 395 – 405) of the Code of Criminal Procedure but also exercises Appellate Jurisdiction under the provisions of Chapter XXIX of the Code of Criminal Procedure.

Take up one idea. Make that one idea your life - think of it, dream of it, live on that idea. Let the brain, muscles, nerves, every part of your body, be full of that idea, and just leave every other idea alone. This is the way to success.

— *Swami Vivekananda*

We are responsible for what we are, and whatever we wish ourselves to be, we have the power to make ourselves.

— *Swami Vivekananda*



CA Kirit S. Sanghvi

Implications of BTPA under Income Tax Act, 1961

1. Introduction

1.1 The Central Government enacted in year 1988 the Benami Transactions (Prohibition) Act, 1988 (the BTPA). The Preamble to the BTPA says it was enacted to prohibit benami transactions and to recover property held benami. The Act of 1988 largely remained unimplemented, for it lacked many provisions that were necessary to make the Act workable. Therefore, the BTPA was amended by the Benami Transactions (Prohibition) Amendment Act, 2016, (the Amendment Act).

1.2 There is a general belief that benami transactions are unaccounted and the property involved in such transaction represents undisclosed income. Though it is not true that every benami transaction involves property that is unaccounted, it is true that a benami transaction serves, among other purposes, also the purpose of concealing income. Therefore, the scope of this paper is to examine the nature of relationship between the BTPA and the Income-tax Act, 1961 (the IT Act). In order to appreciate the relationship, a brief introduction to the BTPA will be helpful.

2. Benami Property and Benami Transaction

2.1 The concepts of 'Benami Property' and 'Benami Transaction" are central to the BTPA. The following are the definitions of "Benami Property" and "Benami Transaction", as amended:

- *"Benami Property" means any property which is the subject matter of a benami transaction and also includes the proceeds from such property.*
- *"Benami Transaction" means –*

  (A) a transaction or an arrangement -

  (a) where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and

  (b) the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration, except when the property is held by –

  (i) a Karta, or a member of a Hindu Undivided Family, as the case may be, and the property is held for his benefit or benefit of other members in the family and the consideration for

such property has been provided or paid out of the known source of the Hindu Undivided Family;

(ii) a person standing in a fiduciary capacity for the benefit of another person towards whom he stands in such capacity and includes a trustee, executor, partner, director of a company, a depository or a participant as an agent of a depository under the Depositories Act, 1996 and any other person as may be notified by the Central Government for this purpose;

(iii) any person being an individual in the name of his spouse or in the name of any child of such individual and the consideration for such property has been provided or paid out of the known sources of the individual.

(iv) Any person in the name of his brother or sister or lineal ascendant or descendant, where the names of brother or sister or lineal ascendant or descendant and the individual appear as joint-owners in any document, and the consideration for such property has been provided or paid out of the known sources of the individual; or

(B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name; or

(C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies knowledge of such ownership;

(D) a transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious;

Explanation – For the removal of doubts, it is hereby declared that benami transaction shall not include any transaction involving the allowing of possession of any property to be taken or retained in part performance of a contract referred to in section 53A of the Transfer of Property Act, 1882, if, under any law for the time being in force –

(i) consideration for such property has been provided by the person to whom possession of property has been allowed but the person who has granted possession thereof continues to hold ownership of such property;

(ii) the contract has been registered.

2.2 It may be seen from the definition that the meaning of "Benami Property" is not difficult to understand; it derives its meaning from the nature of the transaction. That is, if a transaction is benami, property involved in the transaction becomes a benami property.

2.3 The feature that is common to the types of benami transactions defined in Clauses (A) to (D) of sub-section (9) of section 2 is that in the case of a property acquired through a benami transaction the ostensible owner of the property is not the real owner of the property with the real owner being identifiable or not. In other words, in each case of a benami transaction, either the ostensible owner of a property is not the real owner or the real owner for whatever reasons is not identifiable or traceable.

3. Income-tax Act and Benami transaction

3.1 As seen above, a benami transaction is such that the identity of the real owner of a property is either hidden or difficult or impossible to establish. The BTPA swings into action in the cases of dubious ownership or complete lack of ownership of property. The BTPA aims at eliminating, subject to the express exceptions, the separation of legal ownership of a property from its beneficial ownership.

3.2 The aim and object of the IT Act is to levy tax on a person in respect of income of the person arising in a particular period. For the purpose, the IT Act levies income tax on the person who owns the income, except in the cases of representative assessees. If, in some cases the owner of income is not identifiable, the IT Act creates a fiction of ownership of income by deeming, based on a rational criterion, a person the owner of the property which may have been found presumably representing the undisclosed income. On other hand, there are provisions in sections 69 to 69B, which provide that if a person has made certain investments or is found to own money, bullion, jewellery or other valuable article not recorded in the books of account, if any, maintained by him, a rebuttable presumption will be made that the assets represent undisclosed income. Unless the person rebuts the presumption by showing to the satisfaction of the Assessing Officer the nature and source of acquisition of the properties, he will be taxable in respect of the undisclosed income represented by the properties.

3.2.1 Thus, the IT Act generally proceeds against the owner of properties for making assessment of his income. If there is a property which is unclaimed, or the identity of its owner is not established or cannot be established, the IT Act ordinarily cannot proceed with assessment of income represented by the property, whereas it is such property which will be the subject matter of the BTPA.

4. Transactions – Benami and Undisclosed

4.1 One more important thing to be noted about a benami transaction is that the determination of a transaction as benami is based solely on the characteristics of the transaction, no reference being made at that stage to the fact whether the transaction involves disclosed income or property or not. This should make one thing clear that if a transaction, which is carried out with accounted income or property, can also be held benami because it meets the characteristics of a benami transaction. Since such transaction involves property that is disclosed, it should not invite any action under the IT Act. For example, Ramesh pays for a car and buys it in the name of Dinesh. The car is intended for the immediate benefit of Ramesh. Ramesh pays the consideration from his known sources. Though the transaction is benami as per the definition of 'benami transaction' it will have no implication on income tax assessment of either Ramesh or Dinesh, because both will be able to explain their source of acquisition of the car. Nevertheless, the transaction being benami, all the consequences provided in the BTPA that follow a benami transaction will follow.

4.2 Thus, only that benami transaction that involves an unaccounted consideration will have implications under the IT Act.

4.3 Whether a benami transaction involves accounted or unaccounted consideration largely depends on the motive behind carrying out the transaction. Section 53 of the BTPA which contains the penal provisions that will follow the execution of a benami transaction reveals the motives with which a person may resort to a benami transaction. Section 53 of the BTPA provides *"…where any person enters into a benami transaction in order to defeat the provisions of any law or to avoid payment of statutory dues or to avoid payment to creditors, the beneficial owner, benamidar and any other person who abets or induces any person to enter into the benami transaction, shall be guilty of the offence of benami transaction."* Section

53 of the BTPA prescribes penalty for entering into a benami transaction. The BTPA also provides for confiscation of benami property.

4.4 The question as to what the motive is has to be decided on the basis of the surrounding circumstances, the relationship of the parties, the motives governing their action in bringing about the transaction and their subsequent conduct – Supreme Court ruling in *Thakur Bhim Singh vs. Thakur Kan Singh (1980) 3 SCC 072*. For example, Ramesh transfers his properties by way of gift to his friend Dinesh. There are no debts incurred by Ramesh. Dinesh wills away the same property to Ramesh who inherits the same properties gifted by him. The transaction of gift to Dinesh would not be suspect as the surrounding facts and the conduct of the parties do not raise suspicion about the transaction being benami. However, if a huge suit for recovery is filed by somebody against Ramesh soon after he makes gift of the properties to Dinesh who wills the properties away bequeathing them to Ramesh, it would show that the transaction is suspect in that the transfer of properties might have been made in contemplation of the action for recovery of dues. Thus, the motive behind a transaction would be revealed by the surrounding facts and circumstances.

4.5.1 There could basically be two motives behind a benami transaction: one, to defeat the provisions of any law, and two, to defraud creditors including Government in respect of statutory dues. Each of the individual motives may have different implications under the IT Act. For example, take the motive to defeat the provisions of a law. Ramesh earns income which is liable to income tax. Ramesh intends to avoid payment of tax on this income, and, therefore, he arranges his affairs in such a manner that income accrues to Dinesh with a tacit understanding that Dinesh will hold the property representing the income for the benefit of Ramesh. The property in the hands of Dinesh representing the income is 'benami', and the whole arrangement by which the income appears to accrue to Dinesh is a benami transaction. The motive behind the transaction is to defeat the provisions of the IT Act. Ramesh may be called upon to pay income tax on the relevant income on the whole arrangement being exposed. Ramesh may also stand the prospects of inviting penal provisions of the BTPA, including the confiscation of property.

4.5.2 The second motive behind a benami transaction could be to defraud creditors including statutory creditors. A benami transaction entered into with a view to defrauding creditors may have different implications under the IT Act. For example, Ramesh is under huge debt which includes statutory dues. In order to save whatever properties he owns, he sells them to Dinesh with a secret understanding that Dinesh will re-transfer the properties to Ramesh at an appropriate time. It is obvious that when a person tries to save his properties from being applied in payment of dues, the properties are recorded and disclosed. The transaction if carried out at fair value should usually have no implication in the IT Act. However, since the purpose of sale is to erode the net worth of Ramesh, the sale consideration may have been fixed at an amount which would be much less than the fair value of the properties, and perhaps at an amount less than even the cost of the properties. The question is whether s.56(2)(x) can apply to a benami transfer of a property whether for a consideration less than the fair value or for a consideration based on fair value of the property? Does the transfer to Dinesh in this case make Dinesh taxable with respect to the difference between the fair value of the properties and the actual consideration paid by Dinesh to Ramesh? The answer will be 'no', provided the transaction is proved to be benami. Section 56(2)(x) of the IT Act should not apply to a transfer if the transaction is held a benami transaction. On this very issue, this is what the Supreme Court said in *Thakur Bhim Singh vs. Thakur Kan Singh (1980) 3 SCC 072, "The second case which is loosely termed a benami transaction is a* *case where a person, who is the owner of the property, executes a conveyance in favour of another without the intention of transferring the title to the property thereunder…* ***in the latter*** *(second case)* ***there is no operative transfer at all and the title rests with the transferor notwithstanding the execution of the conveyance".***

4.5.2.1 Going by this statement of law, there is no 'transfer' in the eyes of law in a transaction of transfer of a property where the transaction is held benami. In the absence of any transfer s.56(2)(x) should not apply irrespective of whether the transactions was carried out at fair value or not.

4.6 A reference should be made to s.50CA that applies to the transfer of unlisted shares, held as capital assets, effected during the previous year 2017-18. Section provides that if the consideration for such transfer is less than the fair value of the shares as determined in the prescribed manner, then the fair value will be deemed to be the consideration for which the shares may be deemed to have been transferred. If a transfer is held benami, the transaction will not exist in the eyes of law, and applying what the SC held in *Thakur Bhim Singh vs. Thakur Kan Singh (1980) 3 SCC 072,* there should be no case for computation of capital gains.

5. Interplay between the BTPA and the IT Act with some specific examples.

Example 1

Mr. A has bought jewellery. Payment for the jewellery has gone from an undisclosed source. Mr. A maintains books of account in which such jewellery is not recorded. Mr. A denies any payment made by him.

The transaction is benami for the reason that the person providing the consideration is not known. However, the question that will arise will be, if sections 69 to 69B of the IT Act are applied and an assessment of income is made, it would imply that the IT Act holds Mr. A the owner of the jewellery. As one may further argue, once the value of the jewellery is taxed as income of Mr. A in his hands, can the jewellery representing the undisclosed income be called benami?

Presume that after investigation, the jewellery is confiscated under the BTPA. Can an assessment in respect of the jewellery be made on Mr. A under the IT Act?

Example 2

Mr. A is found to be the owner of certain gold. However, he had purchased the gold in the name of Mr. B. The IT authorities enquire with Mr. B about his source of gold. Mr. B satisfactorily explains that the consideration was provided by Mr. A. On being enquired, Mr. A fails to explain his source of acquisition of gold. Mr. A will be taxed, for he is deemed to be the owner of gold. The transaction is benami under the BTPA, and the gold is liable to be confiscated.

However, can Mr. A argue that since he is deemed to be the owner of gold for the purpose of taxation, the property is no longer benami? In author's view, Mr. A cannot argue that since he is proved to be the owner of gold, it is not a benami property, for the reason that the transaction is held benami on the ground that the property is acquired not in the name of the person who has provided consideration but it has been acquired in the name of another person. Therefore, Mr. A's being proved the owner of the gold makes the value of the gold assessable under the IT Act and it also makes the property benami under the BTPA.

6. Can the application of the IT Act to a situation frustrate the application of the BTPA? Or vice versa?

The two examples given above raise an issue. Can a position taken in the IT Act or in the BTPA with regard to a property pre-empt action under the other legislation?

6.1 Sections 69 to 69B create a fiction and deem certain properties like investments, money, gold, bullion, jewellery or any valuable article not recorded or recorded not at the full value in the books of account, if any, maintained by the owner of the properties, as representing untaxed income, if the owner fails to satisfy the Assessing Officer as to the nature and source of acquisition of the properties. It may be noted that these provisions apply to the owner or to the person found to be the owner of unrecorded investments, money, gold, bullion, jewellery or any valuable article. For example, Mr. A makes investment in a property with his undisclosed income in the name of Mr. B. The property is intended for the use of Mr. A. Since Mr. B is the owner on record, he will be asked to explain the nature and source of his acquisition of the property. Mr. B can disown ownership by explaining that it was Mr. A who paid for the acquisition of the property. However, if Mr. B owns up the transaction by not providing any explanation as to the nature and source of the acquisition of the properties, he will be taxed by applying s.69 of the IT Act. Since the property on record is owned by Mr. B who is presumed to have paid for the property, the transaction ceases to be a benami transaction. Thus, the provisions of sections 69 to 69B of the IT Act, if successfully applied by the Revenue, will run counter to the purpose of the BTPA which becomes active only in cases of 'no-claim-for-ownership' or in the cases of the ostensible owner not being the real or beneficial owner.

6.2 In the example above, if the authorities under the BTPA can prove that the property is paid for by Mr. A, and not by Mr. B as claimed, the transaction will be a benami transaction with the benami property liable to be confiscated besides making the parties liable for the consequences. In that case, no assessment of income can be made on Mr. B, the ostensible owner, since he is disproved to be the owner.

6.2.1 A question may be raised here that the finding of Mr. A's ownership was arrived at under the BTPA whereas Mr. B was owner for the purpose of the IT Act, and since the findings are under two different legislations enacted for different purposes, the finding arrived at under one legislation cannot necessarily apply to the other. Author is of the view that both, the IT Act and the BTPA, deal with the concept of ownership of property and do not construe the concept differently, that is, if a person is found owner of a property for the purpose of the IT Act, there is no reason why he should not be regarded as owner for the purpose of the BTPA. The Supreme Court applied a fiction created under the Criminal Procedure Code for the purpose of applying a provision of the Indian Penal Code in *Kumaran vs. State of Kerala (Criminal Appeal Nos. 896-897 of 2017).* The SC held that a fiction should be confined to the purpose for which it is enacted, but if resort has to be made to another legislation to fully serve the purpose for which the fiction was created, then the fiction is valid for the other legislation. In the case of ownership of a property under the IT Act and under the BTPA, the same concepts of 'ownership' operate in both the legislations. Therefore, there should be no bar to adopt the position taken in one legislation as to the ownership of a property in the other legislation. This will avoid conflict between the IT Act and the BTPA.

7. Practical problems

Possibilities have been shown above that a transaction may be benami as also involving tax evasion. An effort is made above to show the areas of possible litigation where a person may argue that since he has paid income-tax in respect of value of a property as owner thereof, the BTPA should not apply to him. Or if the BTPA has been applied to him, then he will resist the assessment based on the value of such property on the ground that he is not regarded as owner for the purpose of BTPA, except in the case where he has paid for the property but acquired in the name of another person, when application of both, the BTPA and the IT Act is possible. However, if the BTPA is applied to a transaction after assessment has been made on the owner, it will be difficult for the owner to have his assessment annulled on the ground that since he is not the owner of the property why he should pay tax.

8. Certain exceptional transactions not to be held benami

One of the benami transactions is one where a property is transferred to or held by a person the consideration wherefor has been paid by another person, and the first person holds the property for the immediate or future benefit of the person providing consideration.

8.1 There are a few exceptions to the general rule. The first exception is a property held by a karta or a member of a Hindu Undivided Family (HUF) for the benefit of the members and the consideration for the property is paid by the HUF from its known sources.

For example: An HUF buys a car for the family. The car is registered in the name of the karta. The transaction and the car will be benami if the HUF has paid the consideration from its sources not known. The IT Act may seek taxation of the karta who is the ostensible owner. Since the consideration is paid from unknown sources, the karta may be taxed. The BTPA may also apply to the transaction.

8.2 The second exception relevant for our purpose relates to provision by an individual of consideration for a property acquired in the name of any child of the individual or his or her spouse. This exception will be available provided the individual has paid the consideration from his known sources. Therefore, if an individual buys a property in the name of spouse paying the consideration from unknown sources, the exception will not be available.

9. Demonetisation and the BTPA

It is official that the RBI received nearly all bank notes of ₹ 500 and ₹ 1,000 denomination which were demonetised on 8th November, 2016, and could be used at banks for exchange for new currency notes. Since nearly all the currency notes returned to the RBI, it means those currency notes that represented "black money" also got deposited into bank accounts and got exchanged for new currency notes. It is quite likely that the owners of black money used bank accounts of other people into which the sums were deposited as belonging to the account holders. Thus, such account holders hold money in their account which was actually provided by another person, and the account holder holds the money for the benefit of the real owner. In such cases, if the Revenue Authorities succeed in proving a person the real owner of the money, the benami character of the money will be proved, but then no assessment on the benamidar will be possible. On the other hand, if the real owner is not detected, the account holder will be deemed to be the owner of the money and will be assessed accordingly, and the BTPA will not apply to the transaction or property.

10. End word

The subject dealt with the article is new, without any precedent available. An attempt is made to see the possible areas of problems. Maybe some problems may not be problems. My readers may pardon for flaws in the article.

> You can not Change your FUTURE, but you can change your HABITS. And Surely your HABITS will change your FUTURE.
>
> — *Dr. A. P. J. Abdul Kalam*


CA Amar Gahlot & Chandni Patel, *Advocate*

Implications of the PBTA under Indirect Tax Laws

Introduction

When the property is held or purchased in the name of another and there is no intention to benefit such another person, the transaction is recognized as a *benami* transaction. In the literal sense of the word, *benami* means 'without name'. And the person in whose name transaction is undertaken in known as *benamidar* who is merely an ostensible owner. The beneficial ownership of the property vests with the real owner being the person on whose behalf the transaction was undertaken.

A classic example of *benami* transaction would be when D provides consideration for purchase of property but asks E to buy the same in E's name. In this example, E will be a *benamidar* and D will be the real owner. However, *benami* transactions are not confined to the example above and are also used to imply a transaction where a person purports to sell the property without intending to transfer the title to the purchaser. The Supreme Court in *Meenakshi Mills Ltd. vs. CIT*[1], has distinguished such transaction from *benami* and held them to be a sham transaction as no consideration flows in the latter case.

Benami transactions have been commonly used in India, even before the British Era, usually as a tool to disguise real ownership. The reason for such a practice was usually to hide the illegal activity underlying such transaction. However, there were other motives like avoiding claims by family members especially in joint Hindu family, defrauding creditors, avoiding payment of taxes or political and social risks[2]. Further, before 1988 such a practice was legally and judicially recognized since not every *benami* transaction was harmful. The Courts generally treated such transaction as that resembling a trust[3]. And while such transactions were not outright *per se* illegal under the Transfer of Property Act, 1882 there were other provisions in various statutes to guard against dishonest use of *benami* transactions. These provisions were scattered under the Indian Trusts Act, 1882 (Section 82), Transfer of Property Act, 1882 (Section 44), Civil Procedure Code, 1908 (Section 66) and Income-tax Act, 1961 (Section 281-A)[4].

Each of these provisions gave legal sanctity to *benami* transaction, recognised the rights of the real owner, addressed the problem of tax evasion

1 [1957] 31 ITR 28 (SC)

2 57th Report of Law Commission on 'Benami Transactions' (1973) pp. 2-4. While citing observation of Federal Court in Punjab Province vs. Daulat Singh, AIR 1942 F.C. 38, 40.

3 Bilas Kunwar vs. Desraj Ranjit Singh, AIR 1915 P.C. 96; Gopeekrist Gosain vs. Gungapersaud Gosain, (1854) M.I.A. 53.

4 These were repealed after the enactment of Benami Transactions (Prohibition) Act, 1988

and checked fraud on creditors. But none of those barred the transaction or declared it as an offence and hence a need for a *benami* law in India was felt as early as 1969, when a select-committee[5] suggested to the Government to have such a law. This was then examined by the 57th Law Commission Report which observed that the existing provisions were not capable of fully addressing the problem at hand. The Law Commission, therefore, recommended a separate legislation to tackle *benami* transactions, since it thought that mere provisions dealing with evasions were not enough, and a more stringent legislation that penalised such transactions was needed as a deterrence.

Law prohibiting *benami* transactions

The recommendations of Law Commission were accepted and enacted in 1988 as *Benami* Transactions (Prohibition) Act, 1988[6] (Benami Act). The Benami Act defined *benami* transaction as one where the property is transferred to one person for consideration provided by another. Further, property was defined very widely to include any kind whether movable or immovable. Benami Act was a piece of penal legislation as it prohibited *benami* transactions subject to stated exceptions and provided for penal consequences[7]. It also barred any right to defences against recovery of *benami* transactions by the real owner[8].

The Benami Act of 1988 though legislated so early, was never notified. Also, it suffered from several procedural infirmities. The authorities created under the statute were not vested with enough power. Also, there was no appellate mechanism available under the law – making it a hurried and incomplete legislation.

The Benami Act was amended radically in 2016[9]. The resulting legal regime on *benami* is more robust in terms of procedure — both legal and administrative. The definition of '*benami* transaction' has been widened and several transactions have been brought into its fold. Further, provisions for attachment and confiscation of property have now become pivotal to the law. Authorities are now empowered to attach *benami* property, if they believe that it might be alienated to frustrate the proceedings. Penal provisions have been now revised, providing for seven years of rigorous imprisonment along with fine. Furnishing of false information also attracts adverse consequences now. As a benevolent measure, a proper appellate mechanism is now in place under the new law. Enforcement of the new law has been entrusted with the Income-tax department[10].

Besides the earlier provisions, the new *benami* law expressly bars from re-transfer of property from *benamidar* to real owner and makes such transfer as null and void. Also, once the property has been determined to be *benami*, the same would become liable to be confiscated and all the rights and title in such property would vest with the Government[11]. Thus, by necessary implication on order of confiscation of property any right of a third person will also be null and void[12]. It must be noted that all these provisions bought into effect by amendment will not have

5 Select Committee on Taxation Laws (Amendment) Bill, 1969

6 Now changed to Prohibition of Benami Property Transactions Act, 1988

7 Benami Transactions (Prohibition) Act, 1988 s. 3

8 Benami Transactions (Prohibition) Act, 1988 s. 4

9 Benami Transactions (Prohibition) Amendment Act, 2016.

10 Notification No. SO 3290E, dated 25.10.2016 passed under Prohibition of Benami Property Transactions Act, 1988 s. 28(2) read with s. 59

11 Prohibition of Benami Property Transactions Act, 1988 s. 5 read with s. 57

12 Prohibition of Benami Property Transactions Act, 1988 s. 27 read with s. 57

any effect on transactions before November, 2016[13].

The effect and implementation of Benami Act

The 2016 amendment has gone to great lengths to give teeth to Benami Act – resulting in an apparently draconian regime. The amendment was brought so that the Benami Act might be effectively used by the Government, and has also furthered the objective behind India's demonetisation scheme of November 2016. Incidentally, the timing of the *benami* law and the demonetisation scheme is overlapping, with both coming into effect in the first week of November.

Thus, it seems that the objective of the amendment of Benami Act was another step in the larger scheme of the Government's crusade against curbing black money and bringing to tax the undisclosed income. The Benami Act is an instrument to detect tax evasion, money laundering activities and in unearthing black money. The identification of several *benami* transactions since the amendment is an evidence of the varying degrees of success in the fight against black money generation and holding. This has been done by issuing show cause notices, for provisional attachment of *benami* properties[14]. Also, provisional attachment has already been effected in many cases and properties attached include deposits in bank accounts and immovable properties[15]. As of September 2017, the tax department has attached 381 properties across the country, worth over ₹ 1,300 crores[16]. The enforcement against *benami* assets is gaining momentum because as of now there are 627 more cases that are under investigation by the tax department. This is a prodigious improvement since in the old Benami Act, there was not a single case of issuance of notice let alone attachment of *benami* property – that law was defunct.

The ripples of transactions covered under the ambit of the Benami Act arise in the Income-tax Act, 1961, Money Laundering Laws (when the property is out of the proceeds of crimes), Foreign Exchange Laws. This article will now examine the possible consequences or effects of *benami* transactions under indirect taxes or the Goods and Services Tax Act (GST).

The GST – Benami interplay

In July 2017, India welcomed a new regime for indirect taxation — the Goods and Services Tax (GST) which subsumed nearly all of the earlier indirect taxes into its fold. Such a drastic change was introduced to overcome cascading effects of taxes which were not plugged by the Value Added Tax (VAT). While income-tax is a tax on the income of a person[17], GST is a charge on consumption of goods or services. In other words, GST is concerned with taxing the pure value addition within a production stage by having a seamless flow of credit mechanism in place. This is in contrast to income-tax which is attracted at the point when income is earned and does not depend upon the destination or manner of utilisation of income[18].

The GST is levy on each and every 'supply' of goods or services unless exempted[19]. Further, the law has defined 'supply' very widely to include all forms of supply made for or without

13 Mithilesh Kumar vs. Prem Bihare Khare, AIR 1989 SC 1247; R. Rajgopal Reddy v. Padmini Chandrasekharan, AIR 1996 SC 238

14 Benami Transactions (Prohibition) Amended Act, 2016, PRESS INFORMATION BUREAU (Mar. 24, 2017) http://pib.nic.in/newsite/PrintRelease.aspx?relid=159882

15 Id.

16 Suchetna Ray, Benami Act impact: Taxman attaches 381 properties worth ₹ 1,300 cr in 9 months, HINDUSTAN TIMES (Sept. 16, 2017) http://www.hindustantimes.com/india-news/benami-act-impact-taxman-attaches-381-properties-worth-rs-1300-cr-in-9-months/story-CzG0j2lWEcUW4gFz21XbkO.html

17 Re Patiala Bank, 9 ITR 95 affirmed in 11 ITR 617 (PC)

18 Tuticorin Alkali vs. CIT, 227 ITR 172 (SC) (FB)

19 Central Goods and Services Tax Act, 2017, No. 12 of 2017, Acts of Parliament, s. 9.

consideration by a person in the course of his business[20]. The law has also kept certain supplies of goods or services outside the purview of 'supply'. As the GST is tax on the value addition made on goods or services, the law provides for an effective credit mechanism to ensure that burden of tax is on the final consumer only. As per the credit mechanism, only a registered person can claim credit of GST paid by him on goods or services if they will be used by him in the course of his business[21].

A *benami* transaction could be of any property whether movable or immovable, tangible or intangible[22]. GST is a transaction based levy that seeks to impose tax on any transaction covered under the scope of the GST law. As long as the transaction involves goods covered by the GST Act, the supplier of the property will collect GST on it. Further, the *benamidar* cannot claim credit of the tax paid on such goods if he doesn't require them in the course of his business. However, if *benamidar* had acquired the goods to be used by the real owner in the course of such real owner's business, then an issue may arise on credit availability at the hands of the real owner as he is just beneficial owner[23].

In a *benami* transaction involving land or building no GST is applicable as both of them are outside the scope of 'supply'[24]. As seen, the Benami Act after amendment provides that even proceeds from the property can be the subject of *benami* transaction. Therefore, if the *benami* transaction also involves earning rental or lease income on such land or building then the *benamidar* being the owner on paper will be liable to pay GST. This is because the activity of leasing and renting is a supply of service under the GST Act. The question of refund does not arise as the supply of service will not be used by the receiver in course of his business. Besides land and building, the transfer of money, shares or securities is also outside the scope of GST[25].

An interesting problem may arise in cases where the benamidar transfers the property to a third person or re-transfers it to real owner. As per GST law, the subsequent transfer of property (except those not covered under GST) will require the benamidar to pay GST. Under the Benami Act, transaction of re-transfer to the real owner and transfer to third party after the notice of attachment are null and void. The Benami Act is also silent in regard to transfer to third party before the issuance of attachment notice and such a transfer may or may not be null and void[26]. To illustrate, section 27(4) of the Benami Act provides that any right of any third person created in a *benami* property with a view to defeat the purposes of the Act shall be null and void. This is a widely worded provision, and which transfers would be hit by it cannot be readily predicted. Thus, the Benami Act itself seems to be not so clear on the 'null and void' consequence in relation to any transfer of a *benami* property. Consequently, the implications under GST and other laws like stamp duty etc., are also not predictable. Let us discuss the two possible scenarios separately.

Assume that consequences of 'null and void' will apply to GST. If GST has been paid, then the transfer being null and void, refund may be

20 Central Goods and Services Tax Act, 2017 s. 7.

21 Central Goods and Services Tax Act, 2017 s. 16.

22 Prohibition of Benami Property Transactions Act, 1988 s. 2(26).

23 The beneficial owner will not be able to comply with the conditions in s. 16(2) of Central Goods and Services Tax Act, 2017.

24 Central Goods and Services Tax Act, 2017 s. 7 read with Schedule III

25 Central Goods and Services Act, 2017 ss. 2(52), 2(102) read with s. 7(1).

26 See Prohibition of Benami Property Transactions Act, 1988 s 27(4) and s 57.

allowed as there was no 'supply'[27]. But it may happen that by the time *benami* transaction gets detected considerable time may have passed making the refund claim fail on the grounds of limitation[28]. However, if the effects of null and void are not recognised under GST law then the Department may allege that the whole scheme involved two transfers – one from real owner to *benamidar* and other from *benamidar* to the real owner. This will make the real owner and the *benamidar* liable to pay GST without any credit[29]. Further, penalty may also be levied on grounds of fraud and suppression of facts on the real owner.

On the other hand, if such transfer to third party is not null and void and the earlier transfer is detected as *benami* transaction. The consequences under GST Law, then, can be either of the two— the department considers transfer by *benamidar* to third party as transfer by real owner in which case there will be no additional liability if GST has already been paid by *benamidar*. The Department can also allege, instead, that the whole scheme involved two transfers— one from real owner to *benamidar* and other from *benamidar* to third party. And as the real owner did not pay GST, the liability will fall on him and *benamidar* will not be allowed to claim credit. Further, penalty may also be levied on grounds of fraud and suppression of facts on the real owner.

It must be noted that if the *benamidar* is charging any fee for lending his name and holding the property for the real owner then irrespective of the nature of property, the fee will be liable to GST. This is because the fee will be consideration for 'supply' of service provided by *benamidar* to the real owner.

Conclusion

The Benami Act is a legislation that the Government seeks to use it as an instrument in curbing tax evasion. The penal statute achieves this objective by bringing to light transactions which hides the real owner and consequently his income. However, as seen above GST is an indirect tax that is a transaction based levy unlike income-tax. Thus, as long as GST is paid on the *benami* transaction and subsequent transfer no drastic consequences will arise for the parties involved. But the interesting issue that arises is whether the ripple of the 'null and void' are felt in GST. Also, adverse GST consequences may arise if the Department chooses to neglect the *benami* transaction and instead construes it to be a disguise for two transfers. Both, the Benami Act and GST law are at a nascent stage of implementation. Given such circumstance and different spheres of operation, it would be interesting to see how the *benami* Act and the GST would be intertwined practically.

27 Refund can be claimed on the grounds that there was no supply and reliance can be placed on section 54(8)(c) of the Central Goods and Services Act, 2017.

28 As per section 54 of Central Goods and Services Act, 2017 refund, in this case, must be claimed within two years from the date of payment of GST.

29 Credit will not be allowed even if conditions under the Central Goods and Services Tax Act are fulfilled because of fraud and suppression of facts by the parties when GST was not paid earlier. See Central Goods and Services Act, 2017 s. 17(5)(i).

Ashish Mehta, *Advocate*[1]

The Prohibition of Benami Property Transactions Act, 1988 – Other important provisions

Introduction

Benami transactions have been prevalent and recognised in India for years. A reference was made by the Union Government to Law Commission in 1972, to examine the relevance of Benami transactions in India and provide a report on whether Benami transactions should be prohibited.

The letter reference[2] sent to the Law Commission read as under:

> *"The problem of property held Benami has been causing concern to the taxing authorities for some time. The Select Committee to the Taxation Laws (Amendment) Bill, 1969 had also suggested that Government should examine the existing law relating to Benami transactions with a view to determining whether such transactions should be prohibited. This suggestion was reiterated in Parliament during the debate on the Taxation Laws (Amendment) Bill, 1971."*

Since, Benami transactions were not prohibited then, there were a number of provisions under various statutes that dealt with rights and obligations of parties entering into Benami transactions. There were a lot of litigations surrounding Benami transactions, as between the benamidar (person lending name) and the real owner (payer of the price for purchase of a property), the law recognised the ownership of the real owner and disregarded the benamidar and it was generally held that the benamidar is only representing the real owner. This further led to litigation when third parties would come into the picture (say a party intending to purchase the benami property from the benamidar) and when the real owner asserted his ownership.

The Law Commission *vide* its report dated 7th August, 1973 after considering the history, reasons, ill-effects and related litigation surrounding Benami transactions and after analysing various options recommended that law should refuse to recognise the Benami transactions, therefore, the Benamidar will be treated as the real owner and such treatment would bring about a cessation of Benami transactions as the real owner would know in advance that he will lose all rights over the benami property and hence would not initiate / undertake such transactions. Recommendations (with certain modifications) were implemented and the President promulgated the Benami

1 Views (if any) expressed in this article are personal views of the author and not of the firm (Khaitan & Co)

2 Source : Law Commission of India – 57th Report Benami Transactions (Aug 1972) – Letter No. 2462 / 72 / Adv. F dated 20th December 1972.

Transactions (Prohibition of Right to Recover Property) Ordinance, 1988 on 19th May 1988 ("Ordinance"). The provisions of the Ordinance received mixed responses and it was termed as a half-hearted move which did not deal with the problem of Benami transactions effectively and completely. Therefore, the Law Commission was again requested to examine the aspects of Benami transactions. The Law Commission submitted its 130th Report titled Benami Transactions – a Continuum and made recommendations to the extent of prohibiting transactions and also recommended that entering into Benami transactions be treated as an offence. The Government considered these recommendations and Benami Transaction (Prohibition) Act 1988 (45 of 1988) was passed in both Houses of Parliament and received President's assent on 5th September 1888.

Three statutory provisions namely Sections 81, 82 and 94 of the Indian Trusts Act, 1882 ("Trusts Act"), Section 66 of the Code of Civil Procedure, 1908 ("CPC") and Section 281A of the Income-tax Act, 1961 ("IT Act") were repealed.

Statutes concerning Benami transactions

Interestingly, the term 'benami' does not figure in many statutory provisions. The word 'benami' remains rather a stray visitor to the world of legislation, though a familiar figure in the judicial sphere.

Legal provisions concerning Benami transactions repealed

1) Provisions of Trust Act – Section 82[3] of the Trusts Act was the most important provision which gave statutory footing to Benami transactions. It read as under:

   "Section 82 Transfer to one for consideration paid by another

   Where property is transferred to one person for a consideration paid or provided by another person, and it appears that such person did not intend to pay or provide such consideration for the benefit of the transferee, the transferee must hold the property for the benefit of the person paying or providing the consideration."

Section 81[4] of the Trusts Act also had similar connotations:

"Section 81 Where it does not appear that transferor intended to dispose of beneficial interest

Where the owner of property transfers or bequeaths it; and it cannot be inferred, consistently with the attendant circumstances that he intended to dispose of the beneficial interest therein, the transferee or legatee must hold such property for the benefit of the owner or his legal representative."

Section 94[5] of the Trusts Act read as under:

"Section 94 Constructive trust in cases not expressly provided for

In any of the case not coming within the scope of any of the preceding sections, where there is no trust, but the person having possession of property has not the whole beneficial interest therein, he must hold the property for the benefit of the persons having such interest, or the residue thereof (as the case may be), to the extent necessary to satisfy their just demands."

These sections were referred to in a number of Court rulings to ascertain the rights and obligations of a benamidar, real / beneficial owners and third parties. One of the views adopted by Courts was that a benamidar had no interest in benami property and he represented the real owner as a mere trustee holding the benami property in trust. There was also

3 Repealed vide Act 45 of 1988 (with effect from 19th May 1988).

4 Repealed vide Act 45 of 1988 (with effect from 19th May 1988).

5 Repealed vide Act 45 of 1988 (with effect from 19th May 1988).

second view prevalent that no interest whatsoever passes on to the benamidar and that the real owner remains the owner of such property. Thus, there was a lot of litigation surrounding benami transactions and interpretation of these sections:

- Vesting and ownership of property.
- Who held the legal title?
- Whether a benamidar could pass a title to a third party?
- Whether the benamidar had a right to sue for possession against a trespasser?
- If a mortgage stood in the name of the benamidar, could the person for whom the mortgage was obtained sue the benamidar?
- Was a benamidar competent to contract in relation to the property at all?

After referring to the controversies surrounding Benami properties, it was recommended by the Law Commission that these provisions (Sections 81, 82 and 94) be repealed. In arriving at this recommendation, the Law Commission in its 130th Report stated that the Trusts Act is vintage, private property was sacrosanct then and every legal device that could be resorted to then was resorted to protect property, hence there was a need to have the doctrine of constructive or resultant trusts during those times. It was observed that in modern day times, such protection was not required to a person entering into Benami transactions.

It was observed that if a person purchases a property, he should have no issues buying it in his own name. Taking shelter under a Benami transaction would only be for illegal or unlawful purposes which could include either to defraud revenue or creditors which may be tainted with criminality. Thus, it was recommended that these provisions (Sections 81, 82 and 94) be repealed and the benamidar be treated as an owner for all purposes (legal as well as practical). An example was provided in the 130th Report to explain this recommendation and is reproduced below:

"To illustrate one point, if a shareholder is recorded as the owner of shares in the Register of Shareholders required to be maintained by the company under Section 155 of the Companies Act, it would be conclusive proof that he is the owner of the shares and nothing to the contrary shall be provable in any proceeding nor any transfer without consideration shall be recognised except where it is by gift".

Thus, following the recommendations of the Law Commission in their 57th Report (recommending repealing of section 82 of the Trust Act) majorly with a view of reduce litigation surrounding Benami transactions as well as their 130th Report (recommending repealing of three sections 81, 82 and 94) as a corollary as Benami transactions were recommended to be prohibited by the Law Commission in their 130th Report, sections 81, 82 and 94 of the Indian Trust Act were repealed in line with the broad intent of the Benami Transaction (Prohibition) Act 1988 (45 of 1988).

2) Provisions of CPC: Section 66[6] of the CPC read as under:

"66(1). No suit shall be maintained against any person claiming title under a purchase certified by the Court in such manner as may be prescribed on the ground that the purchase

6 Repealed vide Act 45 of 1988 (with effect from 19th May 1988).

was made on behalf of the plaintiff or on behalf of someone through whom the plaintiff claims."

Section 66(1) of CPC provides that no suit shall be maintained against any person claiming title under a purchase certified by the Court on the ground that the purchase was made on behalf of the plaintiff or on behalf of someone through whom the plaintiff claims. The Law Commission in its 57th Report also mentioned that in their 54th Report concerning CPC, they recommended prohibition of the plea of defence of benami transactions in general. In the said 57th Report, the Law Commission recommended repealing Section 66 of the CPC. This recommendation was accepted and incorporated in the Ordinance (on the ground that no rights were to be given to benami holders) as well as the Benami Transaction (Prohibition) Act, 1988 (45 of 1988) (as under this law entering into Benami transactions itself was notified as an offence and hence the provision of Section 66 of CPC was not required).

3) Provisions of IT Act: Section 281A[7] of the IT Act

Prior to its repeal, section 281A as inserted by the Taxation Laws (Amendment) Act, 1972, w. e. f. 15-11-1972 and amended by the Finance Act, 1984, w. e. f. 1-4-1984, read as under:

"281A. Effect of failure to furnish information in respect of properties held benami.-

(1) No suit to enforce any right in respect of any property held benami, whether against the person in whose name the property is held or against any other person, shall be instituted in any court by or on behalf of a person (hereafter in this section referred to as the claimant) claiming to be the real owner of such property unless notice in the prescribed form and containing the prescribed particulars in respect of the property has been given by the claimant within a period of one year from the date of acquisition of the property to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(1A) Where any such property is acquired by the claimant before the 1st day of March, 1984, the provisions of sub-section (1) shall be deemed to have been fulfilled if notice in the prescribed form and containing the prescribed particulars in respect of the property is given by the claimant, within a period of one year from the said date, to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(1B) Notwithstanding anything contained in sub- section (1) or sub-section (1A), in relation to any suit relating to any immovable property of a value not exceeding fifty thousand rupees, the provisions of sub-section (1) or, as the case may be, sub- section (1A), shall be deemed to have been fulfilled if, at any time before the suit, notice in the prescribed form and containing the prescribed particulars in respect of the property has been given by the claimant to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(2) …..

While there are many provisions under the IT Act dealing with transfer of income (clubbing provisions – Section 64 of the IT Act) and prohibition of tax avoidance or provisions restricting parting with assets to avoid tax recovery (Section 281 of IT Act deeming certain transfers as void), there is no provision barring entering into Benami transactions.

7 Repealed vide Act 45 of 1988 (with effect from 19th May 1988).

One of the major motives of entering into a benami transaction could be evasion of due taxes (income tax as well as wealth tax) on income / wealth in the hands of the real owner. It is to be noted that there were no provisions under the IT Act that prohibited benami transactions (IT Act is a statute that refers to the word benami – the other statutes (Trusts Act, CPC) discussed above merely draw inferences that hint to benami nature transactions). Section 281A of the IT Act merely prescribed for reporting of benami transactions. These reporting requirements broadly were to ensure that the Indian Tax Authorities concerned with administration of income and wealth taxes had full knowledge of the transactions that were claimed as Benami transactions by parties. Under this provision, no suit would be instituted in any court to enforce any right in respect of any property held as benami unless the claimant has either disclosed the property in question or income therefrom, in connection with his wealth tax or income tax assessments or informed the Tax Authorities about the particulars of such benami property in the prescribed form.

Since Benami transactions were to be prohibited under the Benami Transaction (Prohibition) Act, these reporting requirements were no longer possible and hence Section 281A of IT Act was repealed.

It is further to be noted that the provisions of the Benami Transaction (Prohibition) Act, 1988 (now known as The Prohibition of Benami Property Transactions Act, 1988) do not apply to the State of Jammu and Kashmir and accordingly the provisions of Sections 281A of the IT Act still continue to apply in the state of Jammu and Kashmir (as they would apply prior to the repeal).

Thus, one would observe that the since benami transactions are now prohibited, regulations concerning rights of parties (Section 81, 82 and 94 of the Trusts Act and Section 66 of CPC) as well as reporting requirements as prescribed under Section 281A of the IT Act became redundant and hence, were repealed.

The Prohibition of Benami Property Transactions Act, 1988 is over-riding as well as supplementary to the provisions of other laws:

Prohibition of Benami Property Transactions Act, 1988 is a special Act to prohibit benami transactions and provides that the benami property will be confiscated by the Central Government[8]. To give effect to such provisions, certain other laws such as land acquisition acts[9], compensation rules, property acquisition guidelines / procedures, etc. need to be overridden so that there are no technical hurdles in the administration of the Benami laws. To overcome these hurdles, Section 67 of the Prohibition of Benami Property Transactions Act, 1988 prescribes that the provisions of this Act will have an overriding effect, notwithstanding any inconsistency in any other law in force.

Section 60 of the Prohibition of Benami Property Transactions Act, 1988 further prescribes that the provisions of this Act shall be in addition to any other laws in force. A combined reading of Sections 60 and 67 would lead to a conclusion that all other laws so long as they are not inconsistent with the Prohibition of Benami Property Transactions Act, 1988 will continue to apply.

8 Section 5 of the Prohibition of Benami Property Transactions Act, 1988

9 The Right to Fair Compensation and Transparency in **Land Acquisition,** Rehabilitation and Resettlement Act, 2013

Similar provisions are found in a number of such Special Acts which are introduced to deal with special transactions / issues. Reference may also be made to Section 48(1) of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (**"Black Money Act"**)[10] which is similar to Section 60 of the Prohibition of Benami Property Transactions Act, 1988 holding that provisions of other laws will continue to be applicable. There are also a number of provisions in the Black Money Act that prescribe that such special provisions of the Black Money act override provisions of other laws.

Nature of offences under the Prohibition of Benami Property Transactions Act, 1988

Section 61 of the Prohibition of Benami Property Transactions Act, 1988 prescribes that an offence under this Act will be non-cognizable. As per Code of Criminal Procedure, 1973 ("CrPC") non-cognizable offences are offences for which a police officer has no authority to arrest without a warrant. Since the offences under the Prohibition of Benami Property Transactions Act, 1988 would generally be in the nature of a civil offence, it is not considered as a serious offence which would require for it be be made a cognizable offence (for which an arrest without a warrant would be required / justified). Due process as prescribed under the CrPC in relation to non-cognizable offences will need to be followed by the concerned authorities to initiate action under the Prohibition of Benami Property Transactions Act, 1988.

Offences by companies

Section 62 of the Prohibition of Benami Property Transactions Act, 1988 prescribes that in case any offence as prescribed under that Act is done by a company, every person who was in charge of the company and conduct of the business of the company at the time of commission of the prescribed offence will be liable for action and punishment along with the concerned company.

This presumption of involvement of the person in charge is rebuttable and if a person is able to demonstrate that a contravention of the Prohibition of Benami Property Transactions Act, 1988 took place without his knowledge, no action shall lie against such person. If a person (who was in charge of the company) is able to prove his / her bonafide and prove lack of knowledge about an offence and that he / she can demonstrate that due care was taken to not violating the Benami laws for which punishment is prescribed, such person will not be liable for any penal action.

It is further prescribed that in case the contravention of any of the provisions of the Prohibition of Benami Property Transactions Act, 1988 has taken place with the consent or connivance of or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such person shall also be deemed to be guilty and be liable to be punished.

These provisions are consistent with similar provisions under other laws (for example - Section 278B of the IT Act, Section 56 of the Black Money Act, etc.). In fact, the provisions of Section 62 of the Prohibition of Benami Property Transactions Act, 1988 including the definitions for 'company' and 'director' are the same as those under Section 278B of the IT Act. Hence, one may refer to the judicial pronouncements under the IT Act to seek guidance on how offences by companies have been dealt with under the IT Act.

10 **Intent of Black Money Act –** An Act to make provisions to deal with the problem of the Black money that is undisclosed foreign income and assets, the procedure for dealing with such income and assets and to provide for imposition of tax on any undisclosed foreign income and asset held outside India and for matters connected therewith or incidental thereto.

The definition of a company as provided in Explanation to Section 62 provides for an inclusive definition to include a body corporate, firm an association of persons or body of individuals whether incorporated or not. Similarly, the definition of a director includes a partner of a firm and any member controlling the affairs of an association of persons or body of individuals.

Safeguards to protect interest of Revenue

While Section 5 of the Prohibition of Benami Property Transactions Act, 1988 provides that any property which is subject matter of a Benami transaction shall be liable to be confiscated by the Central Government, there are certain prescribed restrictions before such benami property is confiscated. There is an embargo (Section 6) on the re-transfer of property by the benamidar to the beneficial owner or any to other person. Section 24 provides for issuance of show cause notice to the benamidar (as well as the beneficial owner, if known) as well as provisional attachment of the property after following prescribed conditions.

It is possible that a benamidar may try and transfer the property to another person to defeat / defer / avoid confiscation of the benami property. In order to deal with such a situation, Section 57 of the Prohibition of Benami Property Transactions Act, 1988 prescribes that any transfer of such property as is referred to in Section 24 notice after issuance of such notice will be null and void. Section 24 overrides any provision that may be contrary in the Transfer of Property Act, 1882 or any other law in force.

The provisions of Section 24 are similar to Rule 16 to the Second Schedule of the IT Act, which also bars transfer of asset after issuance of notice under Rule 2 to the Second Schedule of IT Act.

In addition, the IT Act has a provision[11] rendering the transfer of an asset void in case there are pending income tax demands / proceedings and a tax clearance certificate as prescribed is not taken by the transferor. However, there are two carve outs to protect genuine purchasers:

- Who were not aware of the pending proceedings / demands and
- Bought the property under consideration for adequate consideration.

Thus, one should consider undertaking proper legal due diligence and background check of a property from a benami laws applicability perspective before buying and ensure that there is no pending action under Benami Act. One may also consider taking adequate indemnities from the seller before concluding a purchase as otherwise the implications could be huge as the transfer may be treated as void and property confiscated by the Central Government with no recourse against the seller.

11 Section 281 of the IT Act

Case Laws Index

Vipul Joshi, Dharan Gandhi, *Advocates*
& CA Viraj Mehta

HOT SPOT
High Court puts a brake on the power of Central Government to issue ICDS!

The most awaited judgment for this esteemed organisation called 'Chamber of Tax Consultants' was delivered on 8th November, 2017. Chamber had filed a writ petition with the Hon'ble Delhi High Court challenging the *vires* of Notification No. 87 of 2017 notifying 10 Income Computation and Disclosure Standards ('ICDS'), Circular No. 10 of 2017 ('circular') wherein the CBDT had issued certain clarifications on ICDS, amendment to section 145 by the Finance Act, 1995 as well as Finance Act 2014, by virtue of which Parliament delegated the power to the Central Government to notify accounting standards and ICDS respectively. The Hon'ble Delhi High Court was pleased to pronounce the judgment and has accepted most of the contentions raised by the Chamber. Since, the judgment has come very recently. We have discussed some of the important aspect of the same in the present article.

Background

By virtue of section 145(2) as amended by Finance Act, 2014, the Legislature delegated the power to notify ICDS to the Central Government(earlier, section 145(2) gave power to the Central Government to issue accounting standards). Such ICDS were to govern the computation of the income under the head 'Profits and Gains of Business or Profession' and 'Income from Other Sources', if the assessee followed mercantile system of accounting. In pursuance of this power, the Government issued 10 ICDS, first in 2015 by virtue of Notification No. 32 of 2015 applicable w.e.f. AY 2016-17. However, the same was postponed by one year. Accordingly, a fresh notification was issued i.e., Notification No. 87/2016 dated 29-9-2016 wherein 10 ICDS were re-notified with some changesand which were made applicable w.e.f. AY 2017-18. The underlying purpose behind issuance of ICDS was to bring certainty and clarity in respect of the computation of income irrespective of the standards followed by the assessee for maintenance of their books of account i.e., AS or IND AS. However, under the guise of bringing certainty and clarity, the Notification had tinkered with the fundamental principles governing the taxability of income and computation of income. The Government, by way of back door legislation, tried to overrule or diffuse some of the fundamental judgments dealing with computation of income delivered by the Hon'ble Supreme Court and the High Courts.

Thus, the whole motive of bringing clarity went for a toss. The assessees were confused whether to follow ICDS or to follow the fundamental judgments. This confusion was also brought out in the first Easwar Committee report, wherein the Committee was quite vocal about the complications which were brought in by the ICDS. In fact in Circular No. 10, the CBDT clarified that the judgment of the Court was rendered without any authoritative guidance and therefore, would stand overruled by the Notification. The Chamber was under an apprehension that such delegation of powers to the Government u/s. 145(2) amounted to giving unfettered and unbridled power to the Central Government, in exercise of which the Government overruled certain important judicial precedents. It was also apprehended that if the present ICDS are not challenged, the Government would in future come out with various other standards leading to unintended consequences. Further, the Chamber also challenged the ICDS on the ground that the power to overrule judgments stands with judiciary itself or with the Legislature and it can, under no circumstance be done by an Act of the Executive. Therefore, this bold challenge by Chamber.

Judgment of the Court

The findings of the Court is divided into different parts for easy understanding:

Excessive Delegation

The Court *prima facie* dealt with the question as to whether delegation of power u/s. 145(2) to the Central Government to notify ICDS was an act of excessive delegation.

The Court found that the intention of the ICDS was in unmistakable terms to prevail over the judicial precedents. Further, this intention was clearly emanating from the clarification issued in the Circular. Therefore, the important question which the Court had to deal with was whether such over ruling of judicial precedents was permissible in exercise of delegated legislative power. The Court, in no uncertain terms, held that the power of Central Government u/s. 145(2) was to notify standards for computation of income and that this cannot be used to bring about a change in the settled principles as laid down in the judicial precedents which seek to interpret and explain the statutory provisions in the Act. Such a power if given to the Central Government would certainly be an instance of unfettered power in the hands of Executive which is unguided and uncanalised. Such an act of changing the method of accounting for computation of taxable income, would partake the character of essential legislative function which can be done by an amendment to the Act by the Legislature itself. The Court held that under the guise of delegated power the Government cannot do what is otherwise impermissible.

Relying upon the judgment of the Hon'ble Supreme Court in case of *Shri Prithvi Cotton Mills Limited vs. Broach Borough Municipality (1969) 2 SCC 283*, the Court held that it is only a competent legislature that can make a validation law to override judicial precedents and that too by actually removing the defect pointed out by such precedents. Such powers are not available to the Executive.The power to enact a validation law is an essential legislative function which cannot be delegated to the Executive.

Thus, the Court laid down two important principles viz., the aspect of computation of taxable income is an essential legislative function. Similarly, the act of over ruling the judicial precedents is an essential legislative function. Such acts, cannot be delegated to the Executive.

The Court also held that the books of account prepared on the basis of a valid accounting method can be rejected by an AO for not complying with the ICDS. This virtually permits an AO to disregard binding judicial precedents.

In light of the above discussion, the Court held that provisions of section 145(2) has to be read down to restrict the power of Central Government to notify ICDS that do not seek to over ride the binding judicial precedents or the provision of the Act. If section 145(2) is not read down then the same would be *ultra vires* the Act and Articles 141, 144 and 265 of the Constitution.

Further, the Court has also held that there are no guiding principles in Section 145(2) of the Act for the scope and ambit of the delegated power of the Central Government.The above statement of the Court in our view is itself sufficient to strike down all the ICDS as any piece of delegated legislation should be notified based upon the guiding principles laid down by the Legislature itself and in absence of such guiding policy, the delegated legislation turns vulnerable.

Whether ICDS are Constitutionally vaild? Whether the Government has overstepped its powers u/s. 145(2)?

After reading down the provision of section 145(2), the Court examined the effect of the ICDS notified under the said section. The Court examined each ICDS separately, which shall be dealt with in later part of this Article.However, the Court laid down certain important principles which are discussed hereunder.

The Court held that the apprehension of the petitioners that ICDS have the effect of modifying the basis of computation of taxable income as recognised in the Act and as interpreted by the Court is justified. The contention of respondent was that the ICDS were inevitable in light of changing trends. Further, it was also argued by the respondent that due to advancement towards IFRS, the taxation base would change which necessitated the notification of ICDS which would lay down the standards for computation of income under the Act, irrespective of the Accountings Standards followed by the assessee. The Court after extensively relying on the judgment of the Hon'ble Supreme Court in case of *Tuticorin Alkali Chemicals and Fertilizers Limited vs. Commissioner of Income Tax (1997) 227 ITR 172 (SC)* held thatit is settled law that accounting standards cannot override the basis on which the taxable income is computed i.e., the provisions of the Act and the judicial precedents. Further, the AS's have existed since 35 years, however, basic taxation principles remained the same and would remain binding even after the application of ICDS. In any case, the Court held that if the Legislature intends to weed out the difference between IND AS and the computation provision, the same can be done by way of an amendment to the Act, like the manner in which section 115JB has been amended.

Reliance on the judgment of J.K. Industries

The Respondent placed heavy reliance on the judgment of the Hon'ble Supreme Court in case of *J.K. Industries Ltd. vs. Union of India (2008) 297 ITR 176(SC).* In the said case, the Supreme Court negatived the challenge to issue of AS 22 under the Companies Act, 1956. The Court distinguished the said judgment on several grounds. The Court held that under the scheme of Companies Act, the power to issue AS 22 by the Government was *intra vires.* Further, AS 22 was issued by the Government primarily to fill in the gaps in the Companies Act or the Rules thereunder. However, under the Income-tax Act, ICDS does not merely fill in the gaps rather it deals with the important aspect of computation of income. In the present case, the ICDS are directly running contrary to the provisions of the Act as well as the judicial precedents, which was not the case before the Supreme Court in the aforementioned case. Accordingly, the Court negatived the reliance upon the judgment in case of J.K. Industries.

After broadly dealing with the above principles, the Court then dealt with each ICDS separately, to the extent challenged by the petitioners.

ICDS 1

In ICDS 1 the petitioner challenged the action of the Executive to do away with the concept of prudence which was well-recognised until earlier. In fact the Respondent accepted the fact that the concept of prudence in general was removed and was replaced by the specific instances of prudence prescribed in different standards. The Court found merits in the contention of the petitioners that the concept of prudence has been removed which was present in the erstwhile AS-1 issued u/s. 145(2). Further, in so far as the averments of the Respondents as to specific instances of prudence being inserted in ICDS were concerned, the Court negatived the argument by citing certain examples of ICDS III, IV and X, wherein on the contrary no concept of prudence was recognised. Further, the Court held that concept of prudence is embedded in section 37(1) and which is also the view of ICAI in its technical guide. The Court accordingly, held that non-acceptance of the concept of prudence is *per se* contrary to the provisions of the Act and therefore, cannot be countenanced. In light of the above discussion, the Court was pleased to strike down entire ICDS 1.

Striking down of ICDS 1 would mean that the concept of prudence would still prevail. One can claim expected loss and marked-to-market loss on the basis of prudence. One of the examples of expected losses which would not be allowed would be loss arising on construction contracts can be claimed by the assessee as soon as it is identified without waiting for the relevant stage of completion. Further, the disclosure requirements under the said ICDS is also done away with.

ICDS 2

The petitioners challenged ICDS 2 on two grounds viz., diffusion of the ruling in case of *Shakti Trading Co. v. CIT (2001) 250 ITR 871 (SC)* and futility of ICDS 2 in light of the binding provisions of section 145A. Both the above contentions of the petitioners were accepted by the Court and it was held that ICDS 2 is also an attempt to overreach the binding judicial precedents by the device of notifications issued by the Central Government. It is an exercise of excessive delegation of legislative power which is impermissible in law. Accordingly, the Court was pleased to strike down ICDS 2 in its entirety.

Striking down of ICDS 2 would mean that valuation of stock would now be as per the existing principles emanating from the Act as well as the judicial precedents. Further, there shall be no disclosure requirement which were so necessitated by ICDS 2.

ICDS 3

The petitioners challenged the taxability of retention money as per the percentage completion method in contravention of the settled legal principles laid down by various High Courts. The High Courts in various decisions had held that the retention money does not accrue to an Aassessee until and unless the defect liability period is over and the Engineer-in-Charge certifies that no liability is attached to the assessee. The Court after considering the case laws and the stand of the petitioner and the respondent, held that the treatment to retention money under Paragraph 10(a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income. By deploying ICDS-III in a manner that seeks to bring to tax the retention money, the receipt of which is uncertain/conditional, at the earliest possible stage, the respondents would be acting contrary to the settled position in law as explained in the above decisions. The Court accordingly, held that Para 10(a) to the extent of treatment given to retention money was *ultra vires.* This, would in effect, bring the status of retention money back to square one and one can still place reliance upon various judgments dealing with the issue of retention money.

ICDS 3 and 9

ICDS 3 and 9 were also challenged on the ground that not all incidental income are allowed to be reduced from contract cost. This treatment was not in consonance with the principles laid down by the Hon'ble Supreme Court in case of *CIT vs. Bokaro Steel Limited (1999)*

236 ITR 315. The Court held that such treatment cannot be sustained in light of the binding Supreme Court judgment.

ICDS 4

The petitioners challenged Para 5 of ICDS 4 which necessitated the assessee to recognise income from export incentive in the year of making of claim. This, the petitioners claimed was running contrary to the judgment of the Hon'ble Supreme Court in *CIT vs. Excel Industries Limited (2015) 358 ITR 295 (SC).* The Court held that Para 5 of ICDS-4 requires an assessee to recognise income from export incentive in the year of making of the claim if there 'reasonable certainty' of its ultimate collection. In Excel Industries (supra), the Supreme Court held that it is only in the year in which the claim is accepted by the Government that a right to receive the payment accrues in favour of the assessee and the corresponding obligation to pay arises in the hands of the Government. Only in such year the income from export incentive can be said to have accrued and can be recognised as income. Therefore, Para 5 of ICDS-4 is not consistent with the law explained by the Supreme Court. To that extent para 5 has been held by the Court to be *ultra vires.* Thus, the law as laid down in the case of Excel Industries (supra) would prevail.

The petitioners also challenged Para 6 of ICDS-4 which permitted only one method, i.e., proportionate completion method. The petitioners claimed that proportionate completion method as well as the contract completion method have been recognised as valid method of accounting under mercantile system of accounting by the Supreme Court in *CIT vs. Bilhari Investment Pvt. Ltd. (2008) 299 ITR 1 (SC)* as well as by the Delhi High Court in *CIT vs. Manish Buildwell Pvt. Ltd. (2011) 245 CTR 397 (Del)* and *Paras Buildtech India Pvt. Ltd. vs. CIT (2016) 382 ITR 630 (Del.).* The Court accepted the contention of the petitioners and was pleased to strike down para 6 of ICDS 4 to the extent it restricted the application of only one method. As a result, the assessees are free to follow either of the two method viz. project completion or percentage completion.

However, one may find that the findings of the Court are restricted to ICDS 4 whereas this issue also arise in ICDS 3. Therefore, an important question would arise as to whether the finding of the Court would also equally apply for construction contracts or would remain restricted to service contracts only? The Court has rendered two important findings in the earlier Paras viz. the Notification cannot run contrary to the judgments as it is in the nature of excessive delegation and that the method of accounting as prescribed by the ICAI cannot prevail over the provisions of the Act and the judgments rendered by the Courts. When the Delhi High Court in the present judgment says that both the methods of accounting are held to be valid for computation of income by Courts, then the same shall equally apply to ICDS 3 also. This is irrespective of the fact that AS 7 prescribes only one method viz., percentage completion method of recognition of income and expense arising from construction contract. Therefore, even though there is no specific finding of the Court *vis-à-vis* ICDS 3, the ratio laid down shall equally apply to ICDS 3.

One of the important issues of recognition of interest income on accrual basis irrespective of reasonable certainty of its ultimate collection did not find favour with the Court. The petitioners argued that interest on non-performing assets of NBFCs would also become taxable on accrual basis even though such interest is not recoverable. The respondent rebutted the same by stating that one can claim deduction u/s. 36(1)(vii) of the Act and that there has been an amendment in the Act viz., insertion of second proviso to section 36(1)(vii) to take care of such situation. Further, the Respondent also justified the treatment on the ground that this Act is to create a mechanism of tracking unrecognised interest amounts for future taxability, if so accrued. In fact the practice of moving debts which the bank or NBFC considers irrecoverable to a suspense account is a practice which makes the organisations lose track of the same. The petitioners countered the said argument on the three counts viz., merely allowing a deduction u/s. 36(1)(vii) cannot allow the Government to alter the concept of accrual of income as laid down by several judgments; the conditions of claiming a deduction under second proviso to section 36(1)(vii) would place an additional burden on the assessees to demonstrate the interest income is really not recoverable and lastly it was contended that no such corresponding provision has been made u/s. 57 of the Act. However, the Court found favour with the arguments and justifications provided by the respondent. It stated that the justification by the respondent clearly demonstrates that this is a matter of a larger policy and has the backing of Parliament with the enactment of section 36(1)(vii). Further, the stand of the petitioners was negatived on the ground that there was no judgment which was sought to be overruled and that the Petitioners did not challenge the *vires* of second proviso to section 36(1)(vii). Here it is pertinent to note that the very same High Court in case of *CIT vs. Vasisth Chay Vyapar Ltd. (2011) 330 ITR 0440 (Del)*, has held that no interest income on NPAs can be taxed in case of NBFCs.

In light of the above finding, taxing of interest income on accrual basis has acquired the consent of the Court. Therefore, to avoid paying taxes on the same, the assessees would have to book the interest income in their books of account and then correspondingly claim deduction u/s. 36(1)(vii) read with the second proviso. This would make the treatment of the assessee full proof.

ICDS 6

The petitioners challenged ICDS 6 on several grounds viz., under ICDS 6, foreign exchange fluctuation as at the end of the year on loan taken for capital purpose would be treated as item of income or expenses which treatment was contrary to the ruling of the Hon'ble Supreme Court in case of *Sutlej Cotton Mills Limited vs. CIT (1979) 116 ITR 1 (SC)*; ICDS 6 also states that marked to market loss/gain in case of foreign currency derivatives held for trading or speculation purposes are not to be allowed which again in view of the petitioners was against the ruling of Supreme Court in case of Sutlej and Woodward Governor; lastly the petitioners challenged the clarification prescribed under Circular 10 for Foreign Currency Translation Reserve Account balance as on 1st April 2016 which was to be recognised as income/loss of the previous year relevant to the AY 2017-18; this in view of the petitioners would amount to taxation of notional income. The Court accepted all the three contentions of the petitioners and in light thereof, ICDS 6 was struck down completely.

This striking down of the entire ICDS 6 would bring back status quo to the treatment of foreign exchange fluctuation and the same has to be governed by the existing judicial precedents as stated above. Needless to say that there would be no disclosure requirements also.

ICDS 7

ICDS 7 pertains to Government grants which *inter alia* provides that recognition of income cannot be postponed beyond the date of receipt of Government grants. This was challenged by the petitioners on the ground that settled principles of accrual of income have been by-passed as a result of such a provision. It was also contended that many a times, conditions are attached to the receipt of Government grant, non-fulfilment of which may lead to return of such amount. In such instance, it cannot be said that there is any accrual of income although the money has been received in advance. The Court held that this again is contrary to and in conflict with the accrual system of accounting. Therefore on the above footings ICDS 7 was declared *ultra vires* to the above extent.

ICDS 8

ICDS 8 *inter alia* deals with valuation of securities held by a person as stock-in-trade. It has been divided into 2 parts. Part A deals with entities other than scheduled banks and public financial institutions whereas Part B deals with scheduled banks and public financial institutions. The petitioner challenged the method of valuation of stock of securities as at the end of the year on bucket system basis. This in view of the petitioners was unnecessary as Accounting standard provides for valuation on item basis. As a result, the Petitioners apprehended that, this would necessitate maintenance of separate books of account for income tax purpose. The Respondent justified the bucket system of valuation as being in consonance with the RBI guidelines. This was countered by the Petitioners on the ground that under Part B, ICDS 8 has prescribed that recognition of securities should be in accordance with the RBI guidelines. To that extent, it is consistent with the RBI norms. However, for those entities not governed by the RBI to whom Part A of ICDS 8 is applicable, the accounting standard prescribed by the AS has to be followed for maintenance of their normal books. Further, it was also argued that under ICDS 2 dealing with valuation of stock, nowhere the bucket approach has been prescribed and therefore, there are contrary methods under ICDS itself. The Court accepted the contentions of the petitioners and held that this change is not possible to be effectuated without a corresponding amendment to the Act and accordingly, the Court declared Part A of ICDS as *ultra vires.*

This would mean that valuation of securities can be done as per the existing methods without changing it for the purpose of ICDS.

Constitutional Validity of Circular

In respect of petitioners challenge to the Circular, the Court held thatin exercise of its power to issue notifications under section 119 of the Act, the CBDT is meant to clarify the law, not change it. At the highest it can additionally notify the change in rates of depreciation etc. Some of the impugned ICDS, however do not merely clarify the existing law. Some of them mandate the applicability of accounting principles, contrary to what is recognised by the Act, for the purpose of computation of income.

As result the Court declared the Circular No. 10/2017 to be unconstitutional to the extent the corresponding provisions of ICDS are struck down. In the Circular the CBDT has taken several controversial stands which are binding on the Department's officer. This would have led to unnecessary litigation, which would now be prevented because of it being struck down.

In our view, the clarifications issued by CBDT in respect of Q.2, 8,9,10, 11, 16, 19 and 25 are struck down.

Conclusion part of the judgment

In the Conclusion part, the Court states that to the extent the specific ICDS as noted hereinbefore have been struck down as *ultra vires* the Act,the impugned Notification Nos. 87 and 88 dated 29th September 2016 and Circular No. 10 of 2017 issued by the CBDT are also held to be *ultra vires* the Act and struck down as such.

Notification No. 88 has also been struck down to the extent the corresponding provisions in the ICDS are struck down. The said notification prescribes amendment in Form 3CD to incorporate ICDS related disclosures. Since, the notification is struck down in part, therefore, there shall be no requirement on the part of CA to make relevant disclosures in their Form 3CD with respect to such part.

Other impact

There are few other issues wherein the ICDS has tried to bypass the judgments but which has not been dealt with specifically by this judgment. Some of the issues are as under:

a. Interest income is taxable on due basis and not on accrual basis.

b. Expenses incurred after the asset is ready to use is a revenue expenditure.

c. Expenses incurred after the set-up of business and before commencement of business is a revenue expenditure

d. In case of sufficient own funds, the presumption of utilisation of own funds would follow.

The above issues are settled as per the judgments of the Courts. However, they are tried to be circumvented by the ICDS.

Further, there may also be judgment which may crop up in future years dealing with any issue for which the ICDS provides for a contrary treatment. A pertinent question would then be whether in such cases, the judgments would prevail or the ICDS?

The answer would be simple. The Court has read down the provisions of section 145(2) to disentitle the Government to overrule any judgments of the Court. Further, the Court has held that aspects of computation of income and the power of overruling the judgments are essential legislative functions which cannot be delegated to the Executive. Therefore, any act to the contrary, even if not dealt with by the judgment would not survive.

Similarly, the clarifications issued in reply to Q.13, 15, 18 and 20 also run contrary to some judgments and therefore, would not survive.

Return of income already filed

An important question would now be as to the impact of this judgment on the returns already filed in compliance with the ICDS. Since, the Court has struck down the ICDS to some extent as being *ultra vires* and unconstitutional, it would mean that such portion of ICDS has no existence at all and such portion is *void-ab-initio*. Further, since the legislation under challenge is an all India statute, therefore once the same has been struck down by any Court, it shall impact and be binding on the entire country. Reliance in this regard is placed on the judgment of the Hon'ble Supreme Court in case of *Kusum Ingots and Alloys Ltd. vs. UOI (2004) 77 DRJ 317.*

No doubt the Department would contest the judgment before the Hon'ble Supreme Court. However, at present the said judgment holds the field. The returns already filed can be revised u/s. 139(5) in accordance with the time limit prescribed so as to remove the impact of ICDS to the extent it is contrary to the said judgment.

Conclusion

This is a landmark ruling given by the Hon'ble Delhi High Court which has in effect put a hurdle in the powers of the Central Government. The Government tried to unsettle several important and fundamental precedents, which clearly brought out their intentions. Therefore, it was necessary to put a brake. This was also necessary as without such brakes, the Government and CBDT, with their mindset and approach, in future, would have used such powers to an unlimited extent. With this judgment, the ICDS have now become a toothless tiger!

If you salute your Duty, You no need to Salute Anybody, But if you pollute your duty, you have to salute everybody.

— Dr. A. P. J. Abdul Kalam

B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

S.2(22)(e) : Any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance. However, the legal fiction in s. 2(22)(e) does not extend to, or broaden the concept of a "shareholder"

CIT-Delhi-II vs. Madhur Housing and Development Company [Civil Appeal No. 3961 of 2013, dated 5th October, 2017]

In *CIT vs. Ankitech Pvt Ltd. (2012) 340 ITR 14,* the Delhi High Court was concerned with a case where the assessee, a company, received advances of ₹ 6.32 crores by way of book entry from Jacksons Generators Pvt. Ltd., a closely held company. The shareholders having substantial interest in the assessee company were also having 10% of the voting power in Jacksons Generators. The AO & CIT(A) held that as the shareholders who held substantial interest in Jacksons Generators also had substantial interest in the assessee company, for purposes of s. 2(22)(e), the amount received by the assessee from Jacksons constituted "advances and loans" and was assessable as deemed dividend. On appeal, the Tribunal, relying on Bhaumik Colour [313 ITR 146 (Mum.) (SB)], deleted the addition on the ground that though the amount received by the assessee by way of book entry was "deemed dividend" u/s 2(22)(e), it was not assessable in the hands of assessee company as it was not a shareholder of Jacksons Generators. On appeal by the department to the High Court, the High Court dismissed the appeal on the basis that:

(i) U/s. 2(22)(e), any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.

The legal fiction in s. 2(22)(e) enlarges the definition of dividend but does not extend to, or broaden the concept of a "shareholder". As the assessee was not a shareholder of the paying company, the "dividend" was not assessable in its hands *(Bhaumik 313 ITR 146 (Mum.) (SB), approved in Universal Medicare 324 ITR 363 (Bom.) & Hotel Hilltop 313 ITR 116 (Raj.)* followed);

(ii) As the conditions stipulated in s. 2(22)(e) treating the loan and advance as deemed dividend are established in these cases, it is open to the Revenue to take corrective measure by treating this dividend income in the hands of the shareholders and tax them accordingly as otherwise it amounts to escapement of income in the hands of those shareholders.

Dismissing the appeal of the Department the Supreme Court held as under:

> "Having perused the judgment and having heard arguments, we are of the view that the judgment is a detailed judgment going into Section 2(22)(e) of the Income-tax Act which arises at the correct construction of the said Section. We do not wish to add anything to the judgment except to say that we agree therewith."

S.2(47)/45 : Entire law on whether a joint development agreement entered into by an owner of land with a developer constitutes a "transfer" u/s. 2(47) and whether the same gives rise to capital gains chargeable to tax u/ss. 45 and 48 of the Income-tax Act explained in the context of the provisions of the Transfer of Property Act, Registration Act and real income theory

Commissioner of Income Tax vs. Balbir Singh Maini Civil Appeal No. 15619 of 2017 (Arising out of SLP (Civil) No. 35248 of 2015), dated 4-10-2017

The Supreme Court had to consider the following substantial questions of law arising from the judgment of the P&H High Court in *Commissioner of Income Tax vs. Charanjit Singh Atwal 378 ITR 244:*

"i) Whether the transactions in hand envisage a "transfer" exigible to tax by reference to Section 2(47)(v) of the Income-tax Act, 1961 read with Section 53-A of the Transfer of Property Act, 1882?

ii) Whether the Income Tax Appellate Tribunal, has ignored rights emanating from the JDA, legal effect of non registration of JDA, its alleged repudiation etc.?

iii) Whether "possession" as envisaged by Section 2(47)(v) and Section 53-A of the Transfer of Property Act, 1982 was delivered, and if so, its nature and legal effect?

iv) Whether there was any default on the part of the developers, and if so, its effect on the transactions and on exigibility to tax?

v) Whether amount yet to be received can be taxed on a hypothetical assumption arising from the amount to be received?"

In the case of Charanjit Singh Atwal (Civil Appeal No. 1565 of 2016) Punjabi Co-operative Housing Society Ltd. was the owner of 21.2 acres of land of which each plot of 500 sq. yards were held by 65 members, each plot of 1000 sq. yds. were held by 30 members and the remaining four plots of 500 sq.yds. were retained by the Society. There was a Tripartite Joint Development Agreement (JDA) dated 25th February, 2007 for development of 21.2 acres of land in village Kansal.

The developers were to make payments in four instalments. A sum of ₹ 3.87 crore was paid on execution of the JDA. ₹ 15.48 crore was to be paid against a registered sale deed for land of an equivalent value of 3.08 acres earmarked on the demarcation plan annexed to the JDA, which was effected by a registered conveyance dated 2-3-2007. The second instalment payment, being ₹ 23.22 crores, was for land of an equivalent value of 4.62 acres, also earmarked on the demarcation plan, which was effected by a registered deed of conveyance dated 25-4-2007. The third instalment payment of ₹ 31.9275 crores was to be made within six months from the date of execution of the agreement or within two months from the date of approval of plans/

design and drawings and grant of the final licence to develop, whichever was later. This was to be for land of an equivalent value of 6.36 acres, also earmarked on the demarcation plan. The balance payment of ₹ 31.9275 crore was to be made within two months from the date of the last payment, towards full and final settlement of the entire payment of ₹ 106.425 crore, for which a registered sale deed for land of an equivalent value being 7.14 acres, also earmarked on the demarcation plan, was to be conveyed. The developers made payments only up to the 2nd instalment payment, and 7.7 acres of land was conveyed as mentioned, which we have been reliably informed, has since suffered payment of capital gains tax for assessment years 2007-08 & 2008-09. The problem which arose for the subsequent assessment years was that, due to pending proceedings, first in the Punjab and Haryana High Court and thereafter in the Delhi High Court, the necessary permissions for development were not granted, as a result of which the JDA did not take off the ground.

For A.Y. 2007-08, the assessee declared capital gains of ₹ 27,58,436/-. The AO held that since the physical and vacant possession was handed over under the JDA, the same would tantamount to transfer within the meaning of Clauses (v) & (vi) of sec 2(47) of the Act. The AO further held that the assessee was owning 1000 sq.yds. plot. The full value of consideration was ₹ 3.675 crore, less cost of acquisition of ₹ 12,81,724/-. Thus long-term capital gain was ₹ 3,54,68,276/-.

The Commissioner (Appeals) and the Appellate Tribunal dismissed the appeal of the assessee.

The High Court allowed the appeal of the assessee and held that the parties had agreed for *pro rata* transfer of land. Secondly, no possession had been given of the entire land in part performance of JDA. Thirdly, possession was given as a licensee for development of the property and not in the capacity of a transferee. Fourthly, the JDA was executed after the amendment in 2001 of sec. 53A of the Transfer of Property Act and therefore, all the essential ingredients of sec. 53A were not fulfilled and consequently transfer u/s. 2(47)(v) of the Act does not apply. Fifthly, whatever amount was received from the Developer, tax on capital gains has already been paid. No further amount has been received in view of the cancellation of the JDA. Lastly, the Tribunal was not right in holding that the assessee is liable to tax on capital gains in respect of remaining land measuring 13.5 acres for which no consideration had been received and which stood cancelled and incapable of performance due to various orders passed by the Supreme Court and the High Court in PILs.

Dismissing the appeal of the Revenue, the Supreme Court held as under:

(i) A reading of the JDA shows that, it is essentially an agreement to facilitate development of 21.2 acres so that the developers build at their own cost, after obtaining necessary approvals, flats of a given size, some of which were then to be handed over to the members of the society. Payments were also to be made by the developer to each member in addition to giving each member a certain number of flats depending upon the size of the member's plot that was handed over. What is important to bear in mind is that payments under the third instalment were only to be made after the grant of approvals and not otherwise, and that it is an admitted position that this was never done because no approvals could be obtained as the High Court ultimately interdicted the project. Also, the termination clause is of great significance because it shows that in the event of the JDA being terminated, whatever parcels of land have already been conveyed, will stand conveyed, but that no other conveyances of the remaining land would take place.

(ii) Section 53A, as is well known, was inserted by the Transfer of Property

Amendment Act, 1929 to import into India the equitable doctrine of part performance. This Court has in *Shrimant Shamrao Suryavanshi & Anr. vs. Pralhad Bhairoba Suryavanshi (D) by LRs. & Ors., (2002) 3 SCC 676 at 682* stated as follows:

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

(1) there must be a contract to transfer for consideration of any immovable property;

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

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

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

(5) the transferee must have done some act in furtherance of the contract; and (6) the transferee must have performed or be willing to perform his part of the contract."

(iii) It is also well-settled by this Court that the protection provided under Section 53A is only a shield, and can only be resorted to as a right of defence. See *Rambhau Namdeo Gajre v. Narayan Bapuji Dhgotra (Dead) through LRs. (2004) 8 SCC 614* at 619, para 10. An agreement of sale which fulfilled the ingredients of Section 53A was not required to be executed through a registered instrument.

This position was changed by the Registration and Other Related Laws (Amendment) Act, 2001. Amendments were made simultaneously in Section 53A of the Transfer of Property Act and Sections 17 and 49 of the Indian Registration Act. By the aforesaid amendment, the words "the contract, though required to be registered, has not been registered, or" in Section 53A of the 1882 Act have been omitted. Simultaneously, Sections 17 and 49 of the 1908 Act have been amended, clarifying that unless the document containing the contract to transfer for consideration any immovable property (for the purpose of Section 53A of 1882 Act) is registered, it shall not have any effect in law, other than being received as evidence of a contract in a suit for specific performance or as evidence of any collateral transaction not required to be effected by a registered instrument.

(iv) The effect of the aforesaid amendment is that, on and after the commencement of the Amendment Act of 2001, if an agreement, like the JDA in the present case, is not registered, then it shall have no effect in law for the purposes of Section 53A. In short, there is no agreement in the eyes of law which can be enforced under Section 53A of the Transfer of Property Act. This being the case, we are of the view that the High Court was right in stating that in order to qualify as a "transfer" of a capital asset under Section 2(47)(v) of the Act, there must be a "contract" which can be enforced in law under Section 53A of the Transfer of Property Act. A reading of Section 17(1A) and Section 49 of the Registration Act shows that in the eyes of law, there is no contract which can be taken cognizance of, for the purpose specified in Section 53A. It is only where the contract contains all the six features mentioned in Shrimant Shamrao Suryavanshi (supra), that the Section applies, and this is what is meant by the expression "of the nature referred to in Section 53A". As has been stated above, there is no contract in the eye of law in force under Section 53A after 2001 unless the said contract is registered. This being the case, and it being clear that the said JDA was never registered, since the JDA has no efficacy in the eye of law, obviously no "transfer" can be said to have taken place under the aforesaid document. Since we are deciding this case on this legal ground, it is unnecessary for us to go into the other questions decided by the High Court, namely, whether under the JDA possession was or was not taken; whether only a licence was granted to develop the property; and whether the developers were or were not ready and willing to carry out their part of the bargain. Since we are of the view that sub-clause (v) of Section 2(47) of the Act is not attracted on the facts of this case, we need not go into any other factual question.

(v) However, the High Court has held that Section 2(47)(vi) will not apply for the reason that there was no change in membership of the society, as contemplated. We are afraid that we cannot agree with the High Court on this score. Under Section 2(47)(vi), any transaction which has the effect of transferring or enabling the enjoyment of any immovable property would come within its purview. The High Court has not adverted to the expression "or in any other manner whatsoever" in sub-clause (vi), which would show that it is not necessary that the transaction refers to the membership of a co-operative society. We have, therefore, to see whether the impugned transaction can fall within this provision.

(vi) The object of Section 2(47)(vi) appears to be to bring within the tax net a *de facto* transfer of any immovable property. The expression "enabling the enjoyment of" takes colour from the earlier expression "transferring", so that it is clear that any transaction which enables the enjoyment of immovable property must be enjoyment as a purported owner thereof. The idea is to bring within the tax net, transactions, where, though title may not be transferred in law, there is, in substance, a transfer of title in fact.

(vii) A reading of the JDA in the present case would show that the owner continues to be the owner throughout the agreement, and has at no stage purported to transfer rights akin to ownership to the developer. At the highest, possession alone is given under the agreement, and that too for a specific purpose – the purpose being to develop the property, as envisaged by all the parties. We are, therefore, of the view that this clause will also not rope in the present transaction.

(viii) The matter can also be viewed from a slightly different angle. Shri Vohra is right when he has referred to Sections 45 and 48 of the Income-tax Act and has then argued that some real income must "arise" on the assumption that there is transfer of a capital asset. This income must have been received or have "accrued" under Section 48 as a result of the transfer of the capital asset.

(ix) This Court in *E.D. Sassoon & Co. Ltd. vs. CIT, (1955) 1 SCR 313 at 343* held: "It is clear therefore that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him."

(x) This Court, in *Commissioner of Income Tax vs. Excel Industries, (2014) 13 SCC 459* at 463-464 referred to various judgments on the expression "accrues", and then held:

"14. First of all, it is now well settled that income tax cannot be levied on hypothetical income. In *CIT vs. Shoorji Vallabhdas and Co. [CIT vs. Shoorji Vallabhdas and Co., (1962) 46 ITR 144 (SC)]* it was held as follows: (ITR p. 148)

"… Income tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in bookkeeping, an entry is made about a 'hypothetical income', which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account."

15. The above passage was cited with approval in *Morvi Industries Ltd. vs. CIT [Morvi Industries Ltd. vs. CIT, (1972) 4 SCC 451 : 1974 SCC (Tax) 140 : (1971) 82 ITR 835]* in which this Court also considered the dictionary meaning of the word "accrue" and held that income can be said to accrue when it becomes due. It was then observed that: (SCC p. 454, para 11)

"11. … the date of payment … does not affect the accrual of income. The moment the income accrues, the assessee gets vested with the right to claim that amount even though it may not be immediately."

16. This Court further held, and in our opinion more importantly, that income accrues when there "arises a corresponding liability of the other party from whom the income becomes due to pay that amount".

17. It follows from these decisions that income accrues when it becomes due but it must also be accompanied by a corresponding liability of the other party to pay the amount. Only then can it be said that for the purposes of taxability that the income is not hypothetical and it has really accrued to the assessee.

18. Insofar as the present case is concerned, even if it is assumed that the assessee was entitled to the benefits under the advance licences as well as under the duty entitlement passbook, there was no corresponding liability on the Customs Authorities to pass on the benefit of duty-free imports to the assessee until the goods are actually imported and made available for clearance. The benefits represent, at best, a hypothetical income which may or may not materialise and its money value is, therefore, not the income of the assessee."

(xi) In the facts of the present case, it is clear that the income from capital gain on a transaction which never materialised is, at best, a hypothetical income. It is admitted that, for want of permissions, the entire transaction of development envisaged in the JDA fell through. In point of fact, income did not result at all for the aforesaid reason. This being the case, it is clear that there is no profit or gain which arises from the transfer of a capital asset, which could be brought to tax under Section 45 read with Section 48 of the Income-tax Act.

In the present case, the assessee did not acquire any right to receive income, inasmuch as such alleged right was dependent upon the necessary permissions being obtained. This being the case, in the circumstances, there was no debt owed to the assessees by the developers and therefore, the assessees have not acquired any right to receive income under the JDA. This being so, no profits or gains "arose" from the transfer of a capital asset so as to attract Sections 45 and 48 of the Income-tax Act.

Low Tax Effect Circular: The CBDT cannot issue any circular having retrospective operation. Consequently, instruction/circular issued on 9-2-2011 directing withdrawal of low tax effect appeals applies only to appeals filed after that date and not to pending appeals. The fact that the CBDT itself *vide* Circular dated 10-12-2015 directed that the instruction to withdraw low tax effect appeals will apply retrospectively to pending appeals has no bearing

CIT, Bangalore I & Anr. vs M/s. Gemini Distilleries Civil Appeal No. 16815/2017 [@ SLP (C) No. 1425/2014, dated 12th October, 2017]

The question raised in this batch of Appeals is as to whether the instructions/circular issued by the Central Board of Direct Taxes on 9-2-2011 will have retrospective operation or not.

This Court in *Commissioner of Income Tax-VIII, New Delhi vs. Suman Dhamija (Civil Appeal Nos. 4919-4920/2015)* has held that instructions/circular dated 9-2-2011 is not retrospective in nature and they shall not govern cases which have been filed before 2011, and that, the same will govern only such cases which are filed after the issuance of the aforesaid instructions dated 9-2-2011.

Learned counsel for the respondents relied upon circular dated 10th December, 2015 and specifically relied upon paragraph 10.

We are of the considered opinion that the Central Board of Direct Taxes cannot issue any circular having retrospective operation. Respectfully following the above decision, we allow the instant Appeals.

The impugned order passed by the High Court dated 2-11-2011 in ITA No. 887/2006 is set aside. The matter(s) is/are remitted back to the High Court for re-adjudication on merits and in accordance with law.

The Civil Appeals are allowed in the above terms.

Our best work is done, our greatest influence is exerted, when we are without thought of self.

— *Swami Vivekananda*

Work on with the intrepidity of a lion but at the same time with the tenderness of a flower.

— *Swami Vivekananda*

Paras S. Savla, Jitendra Singh, Nishit Gandhi
Advocates

DIRECT TAXES
High Court

1. Appeal before High Court u/s. 260A – Procedure of hearing – Appellant raising allegation that he has no faith in integrity on the Bench

CIT vs. M. H. Patel [Income Tax Appeal No. 584 of 2014, Bombay High Court, order dated 06-09-2017]

The assessee had challenged certain order passed by the CIT (A) in his case before the Income Tax Appellate Tribunal. The assessee personally appeared and represented before the Tribunal. Before the Tribunal an objection was raised alleging lack of faith and trust in Members of the Tribunal. As a result some of them recused themselves from the proceedings. The assessee had also raised objections stating that Ld. Departmental representative was delaying the hearing with *mala fide* intents. Further one of the objection raised was notice u/s. 143(2) was illegal and bad in law. The Asstt. Commissioner subsequently gave the report that it is a typographical error, the fact is that the record indicates that the proposal was sent for AY 2001-02 but notice was issued for AY 2000-01. The Tribunal noting the above allegations, decided in favour of the assessee, on the technical issue that selection of the case suffers procedural lapses and notice u/s. 143(2) being issued without approval of JCIT was bad in law. The department filed an appeal before the High Court. In the High Court the assessee personally represented in the departmental appeal. The assessee stated that he had filed an application before the Hon'ble Chief Justice alleging therein that he had no faith in the impartiality or integrity of one of the Judges hearing his appeal and he had specifically requested his Lordship, i.e. the Chief Justice to assign his matter to another Bench. He therefore requested that since this written objection was on record, at least one of the Judges should recuse himself from hearing his case any further. The Court relied on the Judgments in the case of *Subrata Roy Sahara vs. UOI – AIR 2014 SC 3241* and *Supreme Court Advocates-on-Record Association vs. Union of India Writ Petition (Civil) No.13 of 2015* (NJAC recusal order) and finally concurred with the views expressed by the same Hon'ble High Court in the case of *Ganesh Ramkisan Bairagi vs. Parwatabai Tukaram Appa Landge [2016] 4 ABR 699*. The Hon'ble High Court observed that it is not the first time the respondent assessee has made such a request. With great pain and anguish the Tribunal has held that the respondent made an application and in which allegations were made of lack of faith and trust even in Members of the Tribunal. Some of them had to recuse themselves from the proceedings. The proceedings, therefore, dragged endlessly. The Court further held that sometimes such ploys or tactics are adopted by litigants so as to delay the obvious. If the delay is to their benefit, then, they can go to any extent so as not to invite an adverse order or anything contrary to their interest. It is that perception which is entertained by the litigants and that is how for a favourable verdict, they resort to every tactic in the book or even impermissible in law or unknown to fairness, equity and justice. In such circumstances the litigant who is appearing in person cannot be given an opportunity to dictate to the Court and to any judicial officer as to who should be the Judge/presiding Judge to whom his cases should be assigned and who should preside over any Division Bench. It is the prerogative of the Hon'ble the Chief Justice and it is he/she who decides how the judicial work should be assigned. Once the Chief Justice assigns judicial work to a Bench, then, it is not unless there is a power exercised otherwise, open to a litigant to call upon the Judges to recuse themselves from judicial work in this manner. The request for recusal was, therefore, refused. The Court further observed that there was a substantial question of law as to whether mistake in mentioning assessment year in the notice can be cured in view section of 292B. The department appeal was thus admitted.

2. Appeal before High Court u/s. 260A – Delay of over a year could not be condoned when sufficient time was provided to get accustomed to the new e-filing procedure for filing appeal

Pr. CIT vs. Regent Automobiles P. Ltd. (ITA No.780/ 2017, Delhi High Court, dated 9-10-2017)

The Department had sought condonation of delay of 586 days on the ground that the delay was caused due to the new e-filing procedures initiated in filing of appeals before the High Court. It was submitted by the Department, that the defects pointed out by the Registry were procedural in nature, and by the time it was rectified, the caveat report expired, and even for rectifying the defects, the entire procedure of e-filing the appeal was to be repeated. The Hon'ble High Court refused to condone the delay in filing of appeal and held that practice directions were issued in consultation with the bar, after allowing sufficient time for the bar to get acquainted with the system and further, the Court had also provided scanning machines at the filing counter so that no difficulty was caused to the bar for switching over to the system of e-filing. Such delay of over one year on such a ground was wholly unacceptable to the Court. The Court was not persuaded to condone the extraordinary delay of 586 days in re-filing the appeal.

3. Section 254(2) – Amendment of reducing time limit to file a miscellaneous petition from 4 years to 6 months cannot be applied retrospectively

District Central Co-op. Bank Ltd. vs. UOI [(2017) 86 taxmann.com 176 (Madhya Pradesh)]

The assessee had requested for an adjournment before the Tribunal since its authorized representative was not well. However, the Tribunal dismissed the appeal by passing an *ex parte* order on 25-8-2015. A Miscellaneous Application u/s 254(2) of the Act was filed by the assessee on 23-8-2016, seeking restoration of the said order.

In the meanwhile, section 254 was amended whereby the time limit for rectifying any error apparent on the face of the order was reduced from 4 years to six months from the date of passing the order with effect from 1-6-2016. In light of the amendment, the Tribunal dismissed the miscellaneous application filed by the assessee, *vide* its order dated 23-12-2016. The assessee filed a writ petition before the High Court. The Hon'ble High Court, relying on the judgment of the Hon'ble Supreme Court in the case of *M. P. Steel Corporation vs. Commissioner of Central Excise – [2015] 7 SCC 58*, held that the amendment reducing the time limit for filing a miscellaneous petition could not be applied retrospectively, as it would extinguish a vested right of action for the assessee. The High Court observed that the legislature should have granted some time to the assessees who could have filed an appeal within a period of four years and the same has not been done till the amendment came into force extinguishing the right to file an appeal. It was held that the miscellaneous application of the assessee should not have been dismissed by the Tribunal and the assessee's writ petition was allowed.

4. Section 254 – Condonation of Delay – Delay in filing of appeal caused due to wrong advice of CA should be condoned by the Tribunal

Vijay Vishin Meghani vs. DCIT – (ITXA No. 493 of 2015, Bombay High Court dated 19-9-2017)

The assessee filed an appeal before the Tribunal after a lapse of 2,984 days, reason being that he had completely relied on the advice of his Chartered Accountant (CA), who had advised him to not file appeals before the Tribunal after the receipt of the order of the CIT (A). According to the CA, since a similar issue was already pending with the Tribunal for the earlier year, the assessee should instead prefer a rectification application for the present assessment years based on the outcome of the appeal for the earlier year pending before the Tribunal. Once the earlier appeal was decided, the assessee filed a rectification application, which was not disposed off by the Revenue within a reasonable period of time. Due affidavits were filed by the assessee and the CA. However, the Tribunal rejected the request for condonation of delay, also passed certain unsavoury remarks against the CA profession. Against the said order of the Tribunal, the assessee preferred an appeal before the Hon'ble Bombay High Court. The High Court allowed the said appeals relying on the judgment of the Hon'ble Supreme Court in the case of *M/s. Concord of India Insurance Co. Ltd. vs. Smt. Nirmala Devi and others – AIR 1979 SC 1666* restored the said appeals to the Tribunal for passing fresh order on merits. The Hon'ble High Court held that in the absence of contemporaneous record or any attempt to falsify the statements on oath, the Tribunal ought to have considered the affidavits filed by the assessee and his CA, more so when the Revenue had not filed any counter affidavit denying any factual statements made by either the assessee or the CA. The High Court took into account that the Department had disposed off the rectification application only after the assessee had moved an application under the Right to Information Act and that the Tribunal should not have decided that the assessee was the sole factor responsible for the delay. It was held that the Tribunal had erred in refusing to condone the delay. The High Court allowed the appeals of the assessee, condoning the delay on condition to pay cost of ₹ 25,000/- per appeal, and the matter being restored back to the Tribunal to adjudication on merits.

5. Assessment in case of search and seizure – Section 153A r.w.s. 143(2) of the Income-tax Act, 1961 – if no notice under section 143(2) is issued within period of six month from filing of return, then the return filed would become final and no scrutiny proceeding could be started in respect of said return. A.Y. 2008-09

Chintels India Ltd vs. DCIT [2017] 397 ITR 416 (Delhi)

The assessee was engaged in the business of horticulture, agriculture and real estate. For A.Y. 2008-09, the assessee filed its return of income on 28-10-2008. The period for issuing notice under section 143(2) of the Act expired on 30-9-2009 and the assessee had not received any notice u/s. 143(2) or 142(1) of the Act. A search and seizure operation u/s. 132 of the Act was conducted at the business and residential premises of the assessee on 26-3-2010. The assessee submitted that nothing incriminating was found during the search relevant to A.Y. 2008-09. The A.O. passed the assessment order dated 30-12-2011 by making an addition of ₹ 84,84,910/- under the head 'bogus depreciation claimed'. On appeal, the Ld. CIT(A) upheld the action of the A.O. The assessee being aggrieved by the order passed by First Appellate Authority preferred an appeal before the ITAT. The assessee submitted before the Tribunal that the assessment for the impugned A.Y. 2008-09 was abated as no notice had been issued either u/s. 143(2) or 142(1) of the Act within the stipulated time. However, the Tribunal upheld the action of the lower authorities by observing that the date of initiation of search was 25-3-2010 and the date of intimation u/s. 143(1) of the Act was 27-3-2010 and thus, as on the date of initiation of the search, the assessment for A.Y. 2008-09 was pending and had not abated. An appeal was preferred before the Hon'ble Delhi High Court. The High Court allowed the appeal of the assessee and held that where notice u/s. 143(2) was not issued within a period of six month from the date of filing of return, the return filed would become final and no scrutiny proceedings could be started in respect of said return. However, on merits, for AY 2009-10 and 2010-11, the High Court had upheld the order of the ITAT in rejecting the claim of depreciation on software, since the Assessee had not substantiated the genuineness of purchase of software with any documentary evidence.

6. Disallowance of business expenditure – Section 14A of the Income-tax Act, 1961 – When there was a failure by Assessing Officer to comply with mandatory requirement of section 14A(2) read with Rule 8D(1)(a) to record his satisfaction, question of applying rule 8D(2)(iii) did not arise.

H.T. Media Ltd. vs. PCIT [2017] 85 taxmann.com 113 (Delhi)

The assessee was engaged in the business of printing and publishing newspapers and periodicals. During the course of assessment proceedings, the assessee stated that it received dividends from mutual funds and other investments, which were made out of its own funds and since no borrowed funds were utilized for the same, no disallowance was made by the assessee. With regard to the administrative expenses, the assessee had *suo motu* made a disallowance of ₹ 3 lakhs, though the investments were under a reinvestment scheme. However, the AO held that the assessee had incurred expenses to manage its investments, and the AO computed the disallowance under Rule 8D(2). On appeal, the CIT(A) upheld that the AO's order. The Tribunal upheld the amount equal to 0.5 per cent of the average value of investments under clause (iii) of Rule 8D(2). The assessee, being aggrieved by the impugned order, filed an appeal before the Hon'ble Delhi High Court. The High Court allowed the appeal filed by the assessee and held that it was mandatory for the AO to examine the records of the Assessee and then record his satisfaction with the correctness of his claim, before making an disallowance as per Rule 8D. This was mandated in section 14A(2) of the Act read with Rule 8D(1)(a) and there was no question of making an addition under Rule 8D(2)(iii).

7. Assessment – Income of any other person – search and seizure – Section 153C of the Income-tax Act, 1961 - in order to justify assumption of jurisdiction under section 153C, documents seized must be incriminating and must relate to each of assessment years whose assessments are sought to be reopened. AY. 2007-08, 2008-09 and 2010-11

PCIT vs. Index Securities (P.) Ltd. [2017] 86 taxmann.com 84 (Delhi)

On 14-9-2010 a search and seizure operation was conducted by the Investigation Wing of the Income Tax Department on the Jagat Group, its Directors, other individuals and connected associates at their business and residential premises. During the search, a number of documents were seized, including the Trial Balance and Balance Sheet for the period 1-4-2010 to 13-9-2010 of the assessee. The AO, on the basis of the seized documents, issued a notice u/s. 153C of the Act to reopen the assessment of the Assessee for the AYs 2005-06 to 2010-11. On appeal the CIT(A) quashed the assessment order and allowed the appeal of the assessee. The Department, being aggrieved by the order, filed an appeal before the Tribunal. The Tribunal allowed the appeal of the Department. Consequently, the assessee filed an appeal before Hon'ble Delhi High Court. The High Court allowed the appeal of the assessee by holding that the essential jurisdictional requirement for assumption of jurisdiction under Section 153C (prior to its amendment with effect from 1-6-2015) *qua* the 'other person' is that the seized documents forming the basis of the satisfaction note must not merely 'pertain' to the other person but must belong to the 'other person'. Further, seized documents must be incriminating and must relate to the assessment years whose assessments are sought to be reopened. Consequently, the High Court quashed the reopening of assessments by the AO.

We are what our thoughts have made us; so take care about what you think. Words are secondary. Thoughts live; they travel far.

— *Swami Vivekananda*

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

DIGEST OF CASE LAWS
Tribunal

Reported Judgments

Section 9(1)(vi) – Royalty – Online targeted advertisement was provided using patented software tools and confidential internet users' data and hence payment for the same was royalty in nature, being payment for the use of patent invention, model, design, secret formula, etc.

Google India (P.) Ltd. vs. Addl. CIT [2017] 86 taxmann.com 237 (Bengaluru Tribunal) Assessment Year: 2007-08 to 2012-13

Facts

The assessee, Google India, provided IT services and ITeS to its overseas group companies. It was also appointed as a non-exclusive authorised distributor of Adword programmes to advertisers in India by Google Ireland. The Google Adword programme facilitated targeted advertisement based on age, gender, usage on website, etc. using patented algorithm/software. The client or the advertiser can create advertisements using keywords that would trigger them to appear on the screen when a user searches using those words on a Google website. If a user clicks on the advertisement, then the advertiser has to pay for the advertisement to whichever Google entity it has a contract with. If the client chose the billing address as India and Indian Rupee as billing currency, then the assessee entered into a contract with the advertiser to display that advertisement as per his specifications. The assessee also provided after-sales services to the clients in India. The placement of the advertisement was decided based on the price bid by the advertisers.

The assessee alleged that it was merely reselling advertisement space and only undertook marketing activities to promote the sales of the advertisement space. The assessee submitted that no intellectual property was transferred by Google to the assessee or to the ultimate advertiser.

The Assessing Officer ('AO') alleged that the payment made by the assessee to Google Ireland was in the nature of royalty as per the provisions of section 9(1)(vi) of the Income-tax Act, 1961 ('Act') as well as the Double Taxation Avoidance Agreement ('DTAA') between India and Ireland. Since the payments were made without deducting of tax, the AO determined the tax liability under sections 201 and 201(1A) of the Act. The Commissioner of Income-tax (Appeals) ('CIT(A)') did not allow the appeal of the assessee, and a further appeal was filed by the Assessee before the

Hon'ble Income Tax Appellate Tribunal ('Tribunal' or 'ITAT').

Held

The Hon'ble Tribunal held that the agreement between the assessee and Google Ireland was not to provide advertisement space, but rather to facilitate the display of advertisement to a targeted customer, using patented tools and software. The Hon'ble Tribunal believed that the advertisement space online was always readily available, but the Assessee provided an additional service of providing targeted marketing by using the patented algorithm. The intellectual property of Google vested in the search engine technology, associated software and other features, and hence the payment to Google Ireland for use of such tools for providing targeted marketing would amount of royalty. Further, the Hon'ble Tribunal also held that the payment by the advertisers was not for advertisement space, but for the placement of the advertisement to a particular targeted customer at a particular time based on the patented Adword programme and the advertisements would change based on the price bids of the advertisers. Though different services were rendered by the assessee under the distribution agreement and the ITeS agreement, both the agreements were interlinked and services were rendered using the customers' usage database, patented software tools and all other Google trademarks and brand. The Hon'ble Tribunal concluded that the payment by the Assessee to Google India was for the use of patent invention, model, design, secret formula, etc. and was accordingly in the nature of royalty as per section 9 of the Act and India-Ireland DTAA.

On another aspect, the Hon'ble ITAT also held that the assessee ought to have deducted tax, whether payment was business profit or royalty, unless, there was an order of the AO u/s. 195 of the Act. Further, it was also dismissed the argument of the assessee that as per the provisions of DTAA royalty was chargeable to tax on receipt basis, and it held that benefit of the DTAA was applicable only to non-residents and not to residents and hence, even though the actual payment was not made in impugned year, the Assessee was to be treated as in default. The Hon'ble ITAT also observed that both the Assessee as well as Google Ireland followed mercantile method of accounting and hence, tax ought to have been deducted with the royalty was accounted for in the books of account of the assessee, even though the payment was made as late as 2014. It was observed that Google Ireland could file a return of income and claim a refund of the tax deducted, if it was of the opinion that the income was not chargeable to tax. The Hon'ble Tribunal was of the opinion that the parties to the transaction had an intention of misusing the provisions of the law, by delaying the actual payment for many years.

Section 201 – Time limit as per section 201(3) was applicable to both residents as well as non-residents payees

Google India (P.) Ltd. vs. Addl. CIT [2017] 86 taxmann.com 237 (Bengaluru Tribunal) Assessment Years: 2007-08 to 2012-13

Facts

The assessee, Google India, made payment to Google Ireland for the sale of advertisement space. The AO alleged that the payment was in the nature of royalty as per the provisions of section 9(1)(vi) of the Act and the India-Ireland DTAA and treated the assessee as an "Assessee-in-default" under the provisions of section 201 of the Act. The assessee contended that the notice, dated November 20, 2012, declaring the assessee in default for AY 2007-08 and 2008-09 was barred by limitation, since it was issued beyond a period of 4 years. The AO alleged that the proceedings was not barred by limitation as it was within the time limit prescribed in section 201(3) of the Act. Further, it was also alleged that the though the time limit prescribed was for residents, it should be applicable even to non-residents.

Held

The Hon'ble Tribunal held that the proceedings u/s. 201 in the impugned case, was within the time limit prescribed as per amended law and the decisions relied upon by the assessee all pertained to the pre-amendment position, where courts, after analysing the provisions of sections 143, 147 and 153, held that a reasonable time limit of 4 years was to be allowed for proceedings u/s. 201. Further, the Hon'ble ITAT also held that the law provided for non-discrimination and irrespective of whom the payment was being made to, a resident payee or a non-resident, the time limit prescribed in section 201(3) would be applicable to the entire class of transactions with both residents as well as non-residents.

Section 92, Section 44 – Transfer Pricing provisions are applicable to insurance companies, though their income is computed under section 44 read with First Schedule

Asst. CIT vs. Max New York Life Insurance Company Ltd. [2017] 86 taxmann.com 239 (Delhi – Trib.) Assessment Year: 2002-03

Facts

The assessee, Max New York Life Insurance Company Ltd., was engaged in the business of life insurance. Amongst others, it had entered into an international transaction with its associated enterprise ('AE') for short-term consultancy and assistance, which entailed developing new insurance products, sales strategy, reinsurance model, underwriting personnel and services. The Transfer Pricing Officer ('TPO') proposed to make an adjustment to the income of the assessee. The assessee contested the order before the CIT(A), both on the ground that transfer pricing provisions were not applicable to it as well as on the merits of the case. The CIT(A) allowed the appeal of the assessee on merits of the case and deleted the adjustment. The Revenue filed an appeal before the Hon'ble Tribunal.

Held

Relying on the provisions of Rule 27 of the Income-tax Appellate Tribunal Rules, 1963, the assessee contended before the Hon'ble Tribunal that transfer pricing provisions were not applicable to it since its income was computed as per the provisions of section 44 read with the First Schedule to the Act. The Hon'ble Tribunal dismissed the contention of the assessee and held that computation provision contained in section 92 was applicable to international transactions falling under any of the heads of income given in section 14 and it was in addition to and distinct from the regular computational provisions contained in the respective parts of Chapter IV. The Hon'ble ITAT observed that the AO, in his draft order, would first compute the income under the individual heads of income as per the normal provisions of the Act, and then later on make an addition of the transfer pricing adjustment under section 92. Section 44 replaced the normal provisions of the Act with the mechanism provided in the First Schedule, but section 92 was in addition to the normal provisions and was hence not replaced by section 44. It was also observed that if there was a specific intention of the legislature to the contrary, then it would have been specifically mentioned in section 44.

Section 92 – For applying CUP, hourly rates of comparable transactions cannot be arbitrary compared with the international

transactions, since they were engaged in different businesses and there was no basis to compare the designation of the personnel of the comparable companies and the assessee

Asst. CIT vs. Max New York Life Insurance Company Ltd. [2017] 86 taxmann.com 239 (Delhi – Trib.) Assessment Year: 2002-03

Facts

The assessee, Max New York Life Insurance Company Ltd., was engaged in the business of life insurance. Amongst others, it had entered into an international transaction with its associated enterprise ('AE') for short-term consultancy and assistance, which entailed developing new insurance products, sales strategy, reinsurance model, underwriting personnel and services. The assessee had applied Comparable Uncontrolled Price ('CUP') method to benchmark this transaction. It was submitted that since the charge out rates of the AE was less than the rates of comparable transactions, the international transaction was held to be at arm's length. The Transfer Pricing Officer ('TPO') rejected the comparable transactions are being only quotations and not actual rates. The TPO selected Transactional Net Margin Method ('TNMM') as the most appropriate method. The TPO alleged that the assessee should have paid to the AE only the actual salary cost of the employees seconded to India plus a markup of the average profit margin of external comparable companies. The excess payment made by the assessee was added to the income of the assessee. The Assessee contested the order before the CIT(A), both on the ground that transfer pricing provisions were not applicable to it as well as on the merits of the case. The CIT(A) allowed the appeal of the assessee on merits of the case and deleted the adjustment. The Revenue filed an appeal before the Hon'ble Tribunal.

Held

On merits of the case, the Hon'ble Tribunal held that the comparable charge out rates selected by the assessee in its Transfer Pricing Study Report was based on numerous assumptions and the companies had expertise in areas different from the assessee's business. The Hon'ble ITAT held that the assessee had compared assignment of employees to India with consultancy services further, the rates of comparable companies for different designations were arbitrarily equated to the designation of the personnel who provided the services to the assessee. However, the Hon'ble ITAT held that the method adopted by the TPO did not conform to Rule 10B(1)(e), which detailed the methodology in which TNMM should be applied. Accordingly, the matter was restored to the TPO by the Hon'ble ITAT.

Full value of consideration – Section 50C r.w.s. 54F – Provisions of section 50C(1) were not applicable to the section 54F for the purpose of determining the full value of consideration

ITO vs. Jai Kumar Parashar [2017] 86 taxmann.com 78 (Jaipur-Trib) Assessment Year: 2011-12

Facts

The assessee sold a property situated at Khasra No. 8175, Thok Maliyan, Ajmer for a consideration of ₹ 24,60,000. The Sub-Registrar of Ajmer adopted the value of property at ₹ 96,03,000. Since, the assessee had not disclosed the sale value adopted by the Sub-Registrar, the case was reopened by issuance of the notice dated 29th May 2013 u/s. 148 of the Act. During the course of assessment the assessee submitted that it has invested the entire amount of ₹ 24,60,000 in the capital gains account scheme for the purpose of purchasing a new house property. Hence, the capital gains was exempted u/s. 54F of the

Act and the provisions of section 50C of the Act would not be applicable. However, the AO observed that the income adopted by the stamp authorities was deemed to have been received by the assessee as section 50C was introduced with a view to prevent evasion of tax and under valuation of the transaction. Thus, the AO computed the long term capital gain of ₹ 70,00,000 after invoking section 50C of the Act. On appeal, the CIT(A) deleted the addition and observed that provisions of section 50C were not applicable to section 54F. The Department being aggrieved by the appellate order preferred the appeal before the Hon'ble Tribunal

Held

The Hon'ble Tribunal held that the consideration which has accrued to the assessee as per the sale deed was ₹ 24,60,000 and the whole of the sale consideration was invested in the capital gains accounts scheme for purchase of the new house property. The consideration as determined u/s. 50C based on the stamp duty authority valuation was not a consideration which has been received by or has accrued to the assessee. Rather, it was a value which has been deemed as full value of consideration for the limited purposes of determining the income chargeable as capital gains u/s. 48 of the Act. Therefore, in the instant case, the provisions of section 54F(1)(a) were complied with by the assessee and the assessee shall be eligible for deduction in respect of the whole of the capital gains computed u/s. 45 r.w.s. 48 and section 50C of the Act. The Hon'ble ITAT concluded that the provision of section 50C(1) of the Act were not applicable to section 54F for the purpose of determining the meaning of full value of consideration.

Unreported judgments

Interest earned on fixed deposit is capital receipt and has to be reduced from the capital work-in-progress when the same is inextricably linked with the business of the assessee

Solarfield Energy Two Pvt. Ltd. vs. ITO [ITA 5076/Mum./2016] dated 11th September, 2017 Assessment Year: 2012-13

Facts

The assessee was a domestic company, wholly owned subsidiary of Kiran Energy Solar Power Pvt. Ltd. The assessee was undertaking 20 MW solar power project under Jawahar-Nehru National Solar Mission, Phase-I, Batch-II. The AO while verifying the details of expenditure in capital work-in-progress found that the assessee has reduced interest on fixed deposits with HDFC Bank amounting to ₹ 11,31,831 from the capital work-in-progress. The AO was of the view that the interest income is to be taxed under Income from Other Sources. According the AO made additions under the head Income from Other Sources. On appeal, the CIT(A) confirmed the addition made by the AO. The assessee, therefore, preferred the appeal before the Hon'ble Tribunal.

Held

The Hon'ble Tribunal observed that it was undisputed that the assessee was awarded the work of setting up solar power plant project in Rajasthan by NVVNL. The NVVNL has entered into a power project agreement with the assessee on 25-1-2012. As per the terms and conditions laid down in the bid one of the financial criteria in Request for Selection (RFS) document requires a newly incorporated company to have the required net worth connected to the capacity of the power project. Therefore, as per the condition the assessee was required to have the net worth of 60 crore. Since, the assessee was not having the required net worth it had to infuse funds for enabling itself to meet the qualification criteria and for this purpose, assessee's parent company KESPPL stepped in and invested convertible preference share of the assessee company. Thus, the infusion of fund was inextricably connected with the setting up of the power project. Further, out of the fund available from issue of equity shares an amount of ₹ 40 crore was temporarily parked in fixed deposit with HDFC Bank Ltd. on 1st March, 2012 as it was not immediately required for implementation of the power project. It was only on 29th May, 2012, the assessee entered into EPC contract with Larsen & Toubro Ltd. for developing the 20 MW solar photo Voltaic Power. These facts clearly demonstrated that the funds required for setting up of power project was temporarily parked in fixed deposits and the interest earned on such deposits has proximate nexus with the setting up of power project. Therefore, the same was capital receipt which was to be reduced from Capital Work-in-Progress. The Hon'ble Tribunal followed the decision of Hon'ble Supreme Court in the case of *Bakaro Steel Ltd. [1991] 236 ITR 315 (SC).*

Cash credit – Section 68 of the Act – Income has to be taxed in the year of completion of the project

ACIT vs. M/s. ISA Enterprises [ITA 4597/ Mum./2015] dated 1st September, 2017 Assessment Year: 2011-12

Facts

The assessee was carrying on the business of a builder and developer under the name M/s. ISA Enterprises (ISAE). A survey action was carried on 26th November 2013 in the business premises of the assessee wherein the statement of partner of the assessee was recorded u/s. 131 of the Act. In the statement while answering the Question No. 21 the partner explained the material impounded during the survey and declared the additional income of ₹ 10,06,81,388 for A.Y. 2014-15. The AO held that the assessee sold flats at and around market value i.e. ₹ 8,44,46,750 but recorded the agreement value at ₹ 5,84,30,000 in the books of account. Thus, the AO concluded that the balance amount of ₹ 2,50,65,000 was received by the assessee in cash outside the books of account and made addition u/s. 68 of the Act. On appeal, the CIT(A) allowed the appeal and deleted addition made by the AO. The Department being aggrieved by the appellate order preferred the appeal before the Hon'ble Tribunal.

Held

The Hon'ble Tribunal observed that the assessee was following the project completion method. The project was completed in the year 2014-15. Therefore, the assessee filed the return on 4-4-2015 for the A.Y. 2014-15 declaring total income at ₹ 4,45,00,710 which has been accepted by the department *vide* assessment order dated 28th December, 2016 u/s. 143(3) of the Act. Thus, no addition was warranted u/s. 68 of the Act. The Hon'ble Tribunal followed the decision of *CIT vs. M/s. Jalaram Jagruti Development Pvt. Ltd. (ITA 1537 of 2010)* and *CIT vs. M/s. Guruprerana Enterprises (ITA 1849 of 2011).*

Section 40(a)(i) : Non-deduction of TDS – Nature of transaction is not commission but discount given on sales it could not be regarded to be commission which is hit by provisions of S. 194H

Dish TV India Ltd. & Anr. vs. ACIT [ITA Nos.3061 & 3062/Mum./2017, 3691 & 3692/ Mum./2017] dated 10th October, 2017 Assessment Years: 2011-12 & 2012-13

Facts

The AO noted that the assessee paid commission charges u/s. 40(a)(ia) of the Act but had not deducted TDS u/s. 194H of the

Act. The AO disallowed commission charges u/s. 40(a)(ia) of the Act on account of non-deduction of tax. Further, the CIT(A) rejected plea of assessee and sustained disallowance u/s. 40(a)(ia) of the Act.

Held

The Hon'ble Tribunal held that examination of documents as whole along with terms and conditions of agreement entered into between assessee and distributor in respect of talk time card was essential to determine true nature of transaction, whether it related to discount or commission. TDS provisions were applicable u/s. 194H of the Act in case it was held that nature of transaction entered into between assessee and distributor was that of commission but in case if it was decided that nature of transaction was not commission but discount given on sales it could not be regarded to be commission which was hit by provisions of S. 194H.

S. 48 : Where income under tripartite agreement had not accrued to assessee, no amount was taxable in hands of assessee thus addition on account of selling development rights should be deleted

ACIT vs. Jawahar B. Purohit & Ors. vs. [ITA No. 3646/Mum./2013] dated 20th September, 2017 Assessment Year: 2010-11

Facts

The assessee firm came into existence on 8th July 2004, and it was granted Letter of Intent (LOI) by Slum Rehabilitation Authority (SRA) dated 16th April, 2005 in respect of certain land occupied by slums. Under the LOI, the assessee firm had constructed Rehabilitation building by agreement dated 12th January, 2007, assessee firm and other construction company in Joint Venture in the name of GM Construction, in which the assessee had 50% share. The said Rehabilitation Project was further executed by the Joint Venture. The Joint Venture had constructed Buildings 1 and 3. On 25th October 2009, a tripartite agreement was entered into between the assessee being MR construction, the JV named GM Construction and a third party M/s. Park View Developers whereby it was agreed as follows i) Assessee firm is called as Developer, ii) Right to develop and sell units granted to the Co-developer being Park View Developers, iii) The assessee firm is provided a consideration for selling right to develop free sale building and towards completing responsibility as developer under LOI, iv) the Joint Venture i.e. GM Construction gives up all its rights in the SRA project and it has removed itself from the site and in consideration thereof it has been paid a consideration of independently.

The AO held that whole of amount being consideration to the assessee firm was income, in which tripartite agreement was entered into, and held that the amount was taxable. According to the AO, as per the JV agreement with Green Bell Housing, all the responsibility for completion of the project was on the JV and not of the assessee and therefore no responsibility rested on the assessee. As no responsibility rested on the assessee firm, therefore whole of the amount was immediately taxable in the hands of the assessee firm. The assessee preferred appeal before CIT(A). The CIT(A) deleted addition holding that tripartite agreement clearly recorded liability of assessee firm as developer under LOI and same could not be ignored and as said work was not complete, revenue could not be recognised. Aggrieved by the decision of the CIT(A), Revenue filed appeal before Hon'ble Tribunal.

Held

The Hon'ble ITAT held that, the assessee under the tripartite agreement has sold right to develop and sell incentive under the LOI. Separate consideration was provided to the

JV towards giving up its right in the project as well as to remove itself from the site. The tripartite agreement clearly provided that the JV had been dissolved. Once the JV was dissolved and it gave up its rights on the SRA project, the assessee was the only and exclusive developer of the SRA project. The income under the tripartite agreement had not accrued to the assessee and no amount was taxable in the hands of the assessee.

Section 54 : Exemption from Long Term Capital Gain – Allotment of flat by the builder under self-financing scheme has to treated as construction and period of three years window will be available for availing deduction u/s 54.

Sanjeev Sinha vs. ITO [ITA No. 1131/Mum./2014] dated 17th October, 2017 Assessment Year: 2009-10

Facts

The assessee claimed deduction u/s. 54 from long term capital gains earned on sale of residential flat booked wherein payment of ₹ 26,00,000 was made by the Assessee as EMD for booking of said residential flat as against total cost of ₹ 30,37,500. The builder issued allotment letter dated 28th July, 2009 along with receipt dated 29th July, 2009 acknowledging receipt of ₹ 26 lakhs. The assessee cancelled the said booking of residential flat on personal reasons. The said amount of ₹ 26,00,000 paid by the assessee as EMD for booking of flat was retained with the builder. Further, the assessee made fresh booking for new residential flat with same builder. The builder allotted a new residential flat to the assessee on 3rd March, 2011 and issued acknowledged receipt of ₹ 26,00,000 as EMD towards the said residential flat. The AO and CIT(A) denied deduction claimed u/s. 54 on the ground that assessee has not purchased the residential flat within two years from the date of transfer/ sale of residential flat.

Held

The Hon'ble ITAT observed that, the assessee invested ₹ 26,00,000 with builder itself to buy a residential flat, which due to personal reasons the assessee cancelled the said flat but allowed builder to continue to hold the said booking amount till 2011, when a new flat was allotted by the builder to the assessee and the same amount, which was held by the builder, was duly appropriated towards new residential flat allotted to the assessee as EMD, which was later treated as part consideration by the Builder. The assessee had made substantial portion of the payment of the new flat and had acquired right, title and interest over said flat within 3 years from the sale of flat. Considering the aforesaid observation, the Hon'ble ITAT held that the assessee got right, title and interest in the said flat within three years from the sale of flat on which the long term capital gain arose, therefore the assessee was entitled for deduction u/s. 54.

> Every idea has to become broad till it covers the whole of this world, every aspiration must go on increasing till it has engulfed the whole of humanity, nay, the whole of life, within its scope.
>
> — *Swami Vivekananda*

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. The Court dismissed Revenue's appeal against Tribunal's exclusion of comparables in the absence of substantial question of law

CIT (International Taxation) vs. Ut Starcom Inc (India Branch)-TS-758-HC-2017(DEL)-TP

Facts

(i) The assessee was engaged in the business of providing software development services (SDS) and marketing support and IT Enabled customer support services (ITES) to its AEs.

(ii) It benchmarked its international transactions by adopting TNMM as the most appropriate method and claimed that its international transactions were at arm's length.

(iii) The TPO rejected the comparables adopted by the assessee and adopted a set of 11 new comparables in the SDS segment and a set of 9 new comparables in the ITES segment.

(iv) The Tribunal held that the following companies selected by the TPO could not be considered as comparable to the SDS segment of assessee:

- Infosys Technologies Limited on the ground that it was a giant risk-taking company having significant intangibles and huge assets leading to exorbitant turnover.
- KALS Information Systems Limited on the ground that it derived income from software products and it was also engaged in executing end to end project through the entire value chain of software development life cycle and there was no segmental data available.
- Tata Elxsi Limited on the ground that it had three sub-segments, namely, Embedded product design services (Design & development of hardware and software), Industrial design and engineering (Mechanical design with a focus on Industrial design) and Animation and Visual effects (Animation and special effects) which were highly complex in nature.

(v) Further, the Tribunal held that the following companies selected by the TPO could not be considered as comparable to the ITES segment of assessee:

- Vishal Information Technologies Limited on the ground that it outsourced most of its work to other vendors/service providers.
- Triton Corporation Limited and Maple eSolutions Limited as it had

an extraordinary event i.e, Maple eSolutions Limited was acquired by Triton Corporation and its IT and ITES operations continued to be suspended due to ongoing global crises and unfavourable market conditions. Further, the directors of both the companies had committed financial irregularities and criminal proceedings were initiated against them.

(vi) Aggrieved, Revenue appealed before the Hon'ble High Court against Tribunal's exclusion of Infosys Technologies and KALS Information Systems in the software development segment and Vishal Information Technology in ITeS Segment.

Held

(i) 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.

2. Where the Tribunal remanded the issue of payment of group charges to the file of the AO repeatedly even though all relevant material was available on record, the Court set aside the Tribunal's order directing it to decide the issue on merits.

Voith Hydro Private Limited (Earlier known as Voith Siemens Hydro Private Ltd) vs. Pr. CIT-TS-771-HC-2017(Del.)-TP

Facts

(i) The assessee was engaged in developing, designing, procuring, erecting, installing all electrical and mechanical parts of hydro power projects and also engaged in engineering, procurement and commissioning (EPC) contracts.

(ii) During AY 2007-08, the assessee entered into an international transaction of intra group services wherein it made payments to its AE for OTO (offer to order) support and application work, public relations and corporate sourcing. In the first round of proceedings, the TPO made an adjustment of 5.42 crore alleging that the assessee failed to demonstrate as to whether it actually received services for the payment made by it and therefore the payment failed the benefit test. The DRP reduced the the addition of ₹ 1.89 crore as the difference was overlapping with royalty which was already accepted to be at arm's length. Further, it upheld the order of the TPO wherein it was held that there was no need for these payments as the assessee could have performed the same task on its own.

(iii) Aggrieved, the assessee filed an appeal before the Tribunal which was dismissed without any clear reasoning. On appeal, the High Court by an order dated 11th February, 2014 remanded the matter to the file of the Tribunal directing it to record reasons afresh after considering the contentions of both the assessee and the Revenue.

(iv) The Tribunal in the second round of proceedings, relying on the decision of the Hon'ble High Court in Cushman Wakefield held that the TPO had exceeded its jurisdiction in making such an adjustment and that actually the issue was whether the payment made by the assessee were incurred wholly for the purpose of business and allowable u/s. 37(1), which was to be determined by the AO. Since the AO neither examined the issue nor rendered any findings as to allowability u/s 37(1), the Tribunal restored the matter to the file of AO to determine the issue afresh after providing an opportunity of being heard to the assessee.

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

Held

(i) The Court held that Tribunal erred in remanding the matter to the file of AO for determination of ALP for group services provided to the assessee by its AE when all the relevant material was available on record.

(ii) Accordingly, it set aside the Tribunal's order and restored the file before Tribunal directing it to decide the issue on merits on the basis of the documents already on record before it.

3. Where the assessee benchmarked the payments made to its US based AE for selling agent services received by it under CUP method adopting the payments by the AE to independent third parties in the USA as comparable, the Tribunal held that since the commission paid by the assessee to AEs was also for services rendered in respect of sales in USA and the scope of services rendered by the AEs was much more than the scope of services being rendered in such cases of uncontrolled comparable cited by the assessee, no adjustment could be made.

Pr. CIT vs Paxar India Private Limited-TS-780-HC-2017-TP

Facts

(i) The assessee entered into an international transaction and paid commission @ 10% to its AE in respect of services received (services as selling agent).

(ii) It benchmarked the above transaction applying CUP method as similar payment was made by the AE of the assessee company to unconnected parties in USA @ 8% who acted as selling agents. It further contended that since the difference was within +/- 5% range, no adjustment was required.

(iii) The TPO / DRP contended that since the uncontrolled comparables cited by the assessee were from USA i.e. a market different from India, the rate of commission paid in those cases could not be compared in the present case.

(iv) The Tribunal rejected the objection of the TPO and held that, the commission paid by the assessee to AEs was also for services rendered in respect of sales in USA. Further, the scope of services rendered by the AEs was much more than the scope of services being rendered in such cases of the uncontrolled comparables cited by the assessee. Accordingly, it held that rate of commission paid in the present case at 10% was at arm's length and deleted the TP adjustment.

Held

1. The Court held that the Tribunal had provided detailed reasons for deleting the TP adjustment and accordingly, it held that no substantial question of law arose. Therefore, it dismissed the appeal of the Revenue.

B. Tribunal Decisions

4. India-Saudi Arabia DTAA – Service P.E. – Solar days are relevant for determination of service PE under the India-Saudi Arabia tax treaty – In the absence of the Fees for Technical Services (FTS) Article in the India-Saudi Arabia DTAA, the income would be taxed as per the residual 'other income' clause in the tax treaty.

M/s Electrical Material Center Co. Ltd. vs. DDIT (International Taxation) [TS-451-The Tribunal-2017 (Bang.)] – Assessment Year: 2010-11

Facts

(i) The assessee was a company based in Saudi Arabia. During the year under consideration, the assessee rendered certain services in India through four of its engineers who were present in India for a period of 90 days.

(ii) The issues before the Tribunal were as follows:

(a) Whether the presence of engineers of the assessee in India constituted a service PE of the assessee as per Article 5(3)(b) of the India-Saudi Arabia tax treaty

(b) Whether the fees received by the assessee for the services rendered by it would qualify as "royalty" or "FTS" under the Income-tax Act, 1961 (the Act) and the tax treaty

(c) Whether in the absence of any specific article for taxability of FTS in the tax treaty, the income would be taxable as per the provisions of the Act

(iii) The Revenue contended that:

(a) The payments received by the assessee from India would qualify as royalty as per the Act and the tax treaty, and accordingly it was taxable at 10%.

(b) The assessee had a PE in India as per Article 5(3)(b) of the tax treaty. Man days were to be considered and not solar days for deciding the existence of PE in India

(c) Reliance was placed on the decision of the THE TRIBUNAL in the case of *ABB FZ-LLC vs. DCIT ITA Nos. 1103 of 2013 & 304 of 2015 (Bengaluru) dated 21st June, 2017* as per which a service PE of the assessee was constituted by rendering of services through virtual modes such as e-mails, internet etc.

(iv) The assessee contended that:

(a) The payments received by the assessee from India was in the nature of FTS and not royalty and in the absence of any specific Article in the tax treaty on the taxability of FTS, the same shall be taxed in Saudi Arabia as "Other Income" under the tax treaty.

(b) Further, for the determination of service PE, solar days was relevant and not man days. The assessee placed reliance on the decision of the Mumbai Tribunal in the case of *Clifford Chance vs. DCIT [2002] 82 ITD 106 (Mumbai).*

Decision

The Tribunal held as under:

(i) The Tribunal, relying on the decision of the Mumbai Tribunal in the case of *Clifford Chance vs. DCIT [2002] 82 ITD 106 (Mumbai)* held that solar days were relevant for determination of service PE as against man days.

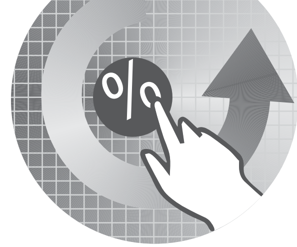
(ii) Multiple counting of the common days was to be avoided so that the days when two or more employees were present in India together, they were to be counted only once.

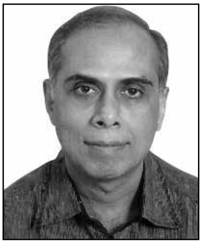
(iii) The Tribunal distinguished its earlier decision in the case of *ABB FZ-LLC vs. DCIT ITA Nos. 1103 of 2013 & 304 of 2015 (Bengaluru) dated 21st June, 2017* wherein the Tribunal held that services were rendered virtually by way of e-mail, internet, VC, etc., as against the facts of the present case wherein engineers were physically present for performance of the services and the invoice was also raised by the assessee on the basis of man hours.

(iv) The stay in India of the assessee by the presence of its engineers was only 90 days and since it was less than 182 days as required under Article 5(3)(b) of the tax treaty, there was no service PE of the assessee in India.

(v) In respect of income not specifically covered under any Article, such income should be taxable under the residual Article on "Other Income" under the tax treaty which provides for taxability in the state of residence only. Reliance was placed on the decision of the Madras High Court in the case of *Bangkok Glass Industry Co. Ltd. vs. ACIT [2013] 257 CTR 326 (Chennai).*

(vi) With respect to whether the income qualifies as royalty or FTS, in absence of the exact details of the work done by service engineers in India, this issue was remitted back to the revenue for determination.





CA Rajkamal Shah

GST impact on Societies, Religious and Charitable Trusts, NGOs – Part - I

Implications of GST on Co-operative societies, religious and charitable trusts, non-profit organisations is a contentious issue. One needs to analyse S. 7 of Central Goods and Service Tax Act (CGST Act)[1] defining 'supply' and this section is replicated in all State Acts. Supply of goods or services or both with the exception of supply of alcoholic liquor for human consumption is chargeable to tax under S. 9.

A perusal of section 9(1) would show that the levy is on intra-State supply of goods or services or both. Therefore, the taxable event is supply. Section 7 deals with scope of supply.

7. (1) For the purposes of this Act, the expression "supply" includes,

(a) *all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;*

(b) *import of services for a consideration whether or not in the course or furtherance of business;*

(c) *the activities specified in Schedule I, made or agreed to be made without a consideration; and*

(d) *the activities to be treated as supply of goods or supply of services as referred to in Schedule II.*

A perusal of section 7(1)(a) would show that the supply should be made or agreed to be made for a consideration by a person in the course or furtherance of business. The rest of the clauses (b) to (d) of section 7(1) are sub-sets of section 7(1)(a). The clauses (b) to (d) of section 7(1) should satisfy the factors stipulated in section 7(1)(a) except to the variation specifically stipulated in the respective clauses.

Before turning to the definition of Business under S.2(17) it is necessary to note that the definition of 'person' as contained under S. 2(84) include a co-operative society registered under any law relating to co-operative societies, society as defined under the Societies Registration Act, 1860, trust and every artificial juridical person not falling under any clause.

S. 2(17) defines 'business' as follows :

"(17) "business" includes—

(a) *any trade, commerce, manufacture, profession, vocation, adventure, wager or any other*

1 Reference to all sections under this article shall be of CGST Act unless otherwise specified.

similar activity, whether or not it is for a pecuniary benefit;

(b) any activity or transaction in connection with or incidental or ancillary to sub-clause (a);

(c) any activity or transaction in the nature of sub-clause (a), whether or not there is volume, frequency, continuity or regularity of such transaction;

(d) supply or acquisition of goods including capital goods and services in connection with commencement or closure of business;

(e) provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members;

(f) admission, for a consideration, of persons to any premises;

(g) services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation;

(h) services provided by a race club by way of totalisator or a licence to book maker in such club ; and

(i) any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities;"

The issue to be considered is that can a co-operative society providing facilities or benefits to its members, a charitable trust registered with the Charity Commissioner, a religious trust or a non-profit organisation automatically be termed as carrying on any business? In the opinion of the writer, the answer is No. Clause (c) of section 2(17) is required to satisfy the normal conditions to qualify as business. It is interesting to note the difference in language used in clauses (a) to (c) of section 2(17) with that used in clause (e) of section 2(17). Clause (a) of section 2(17) dispenses with the requirement of profit motive. There is no specific dispensation of profit motive in clause(e) of section 2(17). Clause(c) of section 2(17) specifically dispenses with the criterion of volume, frequency, continuity or regularity in respect of activity or transaction of the nature stipulated in clause (a) of section 2(17). There is no specific dispensation of these factors in case of clause(e) of section 2(17). In fact, clause(c) of section 2(17) makes a specific reference only to clause(a) of section 2(17) and not to any other clauses of section 2(17). Therefore, clause(e) of section 2(17) should satisfy the normal attributes of 'business'.

The expression 'business' has been subject-matter of judicial interpretation in several decisions. It is relevant to note certain judgments. In the following decisions, it has been held that in order to qualify as business, there should be regularity and some sort of continuity in the activities and there should be profit motive. It has been further held that if the main activity is not business, the incidental activity would also not qualify as business.

- *Commissioner of Sales Tax vs. Sai Publication Fund [2002] 126 STC 288 (SC):*

In the words of the Hon'ble Supreme Court, *"It may be stated that the question of profit-motive or no profit-motive would be relevant only where person carries on trade, commerce, manufacture or adventure in the nature of trade, commerce, etc. On the facts and in the circumstances of the present case irrespective of the profit-motive, it could not be said that the Trust either was "dealer" or was carrying on trade, commerce, etc. The Trust is not carrying on trade, commerce, etc., in the sense of occupation to be a "dealer" as its main object is to spread message of Saibaba of Shridi as already noticed above. Having regard to all aspects of the matter, the High Court was right in answering the question referred by the Tribunal in the affirmative and in favour of the respondent-assessee. We must however add here that whether a particular person is a "dealer" and whether he carries on "business" are the matters to be decided on facts and in the circumstances of each case".*

This decision is directly on the point supporting the case of the respondent after noticing a number of decisions on the point including the decisions cited by the learned counsel before the Court. It is worth mentioning that S. 2(5A) of Bombay Sales Tax Act had the similar definition of the term, 'business' :

"Section 2(5A):*'business' includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern; and any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern; and any transaction in connection with, or incidental or ancillary to, the commencement or closure of such trade, commerce, manufacture, adventure or concern;"*

The term, 'dealer' also did not necessitate the existence of remuneration for business of buying or selling of goods. S.2(11) of Bombay Sales Tax Act reads as follows :

'Dealer' means any person who whether for commission, remuneration or otherwise carries on the business of buying or selling goods in the State, and includes the Central Government, or any State Government which carries on such business and also any society, club or other association of persons which buys goods from or sells goods to its members."

As regards to the incidental activity to the main activity the decision is a torch bearer. In the words of Hon'ble Supreme Court,

"11. No doubt, the definition of "business" given in section 2(5A) of the Act even without profit-motive is wide enough to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture and any transaction in connection with or incidental or ancillary to the commencement or closure of such trade, commerce, manufacture, adventure or concern. If the main activity is not business, then any transaction incidental or ancillary would not normally amount to "business" unless an independent intention to carry on "business" in the incidental or ancillary activity is established. In such cases, the onus of proof of an independent intention to carry on business connected with or incidental or ancillary sales will rest on the Department. Thus if the main activity of a person is not trade, commerce, etc., ordinarily incidental or ancillary activity may not come within the meaning of 'business'. To put it differently, the inclusion of incidental or ancillary activity in the definition of "business" pre-supposes the existence of trade, commerce, etc. The definition of "dealer" contained in section 2(11) of the Act clearly indicates that in order to hold a person to be a "dealer", he must "carry on business" and then only he may also be deemed to be carrying on business in respect of transaction incidental or ancillary thereto. We have stated above that the main and dominant activity of the Trust in furtherance of its object is to spread message. Hence, such activity does not amount to "business". Publication for the purpose of spreading message is incidental to the main activity which the Trust does not carry as business. In this view, the activity of the Trust in bringing out publications and selling them at cost price to spread message of Saibaba does not make it a dealer under section 2(11) of the Act."

The Hon'ble Supreme Court has taken similar view in *State of Tamil Nadu vs. Board of Trustee of the Port of Madras [1999] 114 STC 520 (SC).* The details of the case and the judgment is not reproduced here for paucity of space. However, it is also relevant for the meaning of the term, "in connection with", "incidental", "ancillary". The Hon'ble judges held that, *"In our view, if the main activity was not 'business', then the connected, incidental or ancillary activities of sales would not normally amount to 'business' unless an independent intention to conduct 'business' in these connected, incidental or ancillary activities is established by the revenue. It will then be necessary to find out whether the transactions which are connected, incidental or ancillary are only an infinitesimal or small part of the main activities. In other words, the presumption will be that these connected, incidental or ancillary* *activities of sales are not 'business' and the onus of proof of an independent intention to do 'business' in these connected, incidental and ancillary sales will rest on the Department. If, for example, these connected, incidental or ancillary transactions are so large as to render the main activity infinitesimal or very small, then of course the case would fall under the first category referred to earlier".*

When the main activity of a charitable trust or non-profit organisation is not for profit or any pecuniary benefit whether the incidental activity though in the nature of sale shall be covered under clause (b) of S. 17 is answered by Bhagwati, J. adverted to the observations of Krishna Iyer, J. in *Royal Talkies, Hyderabad vs. Employees State Insurance Corporation, 1978 (4) S.C.C. 204,* a decision under the E.S.I. Act to the following effect :

"a thing is incidental to another, if it merely pertains to something else as primary, surely, such work should not be extraneous or contrary to the purpose of the establishment but need not be integral to it either."

The word 'incidental' in Section 2(d)(ii) came up for consideration in *State of Tamil Nadu vs. Binny Ltd., Madras, 1980 Suppl. S.C.C. 686,* cited for the respondent - Port Trust. The company was having business of manufacture and sale of textiles. It was also running a store in the premises of the factory to enable the workmen to buy provisions which were assessed to tax. The sales to workmen were on no profit basis. The company contended that it was only running a facility for its workmen and its main business was certainly not that of selling provisions. The issue related to 1967-68 alter amendment of Section 2(d) of the Madras Act. The argument that there should be a 'direct' connection between the main business and these sales of provisions was rejected by the Court.

"Finally, we come to the Naval Dockyard case in Base Repair Organisation, (Now Naval Dockyard), Visakhapatnam vs. The State of A. R, (1983) 53 S.T.C. 223 (A.P.). Here the Naval Dockyard was established for repairing and servicing ships of the Navy. It was obliged by Section 46 of the Factories Act to run a canteen to cater to the needs of its employees and the canteen was run on no-profit no-loss basis. It was held that the sales in the canteen were not liable to sales tax. It was held as follows :

"It should be noticed that the canteen is not only being run in discharge of a statutory obligation, but that it constitutes an infinitesimal and insignificant part of the entire activity of the assessee. Having regard to the nature of the functions and the purpose for which the Naval Dockyard is established, and also because of the fact that the canteen subserves the main object and purpose of the assessee and is an integral and inseparable part of it, it would be unreaslistic to separate the said activity and treat it as a business."

From the above discussion, it is inferred that if the main activity of the Trust or NGO is not regarded as business, the incidental or ancillary activity to the main activity would also not be regarded as business unless such activity is so overwhelmingly and predominantly held to be overshadowing in the main activity by the number and the volume of the transactions.

On this background we shall now examine GST implications on co-operative societies, religious, trusts, charitable trusts and other NGO.

Co-operative housing societies including housing, commercial and industrial societies.

It is thus clear that though the definition clause (e) of S. 2(17) of 'business' include provision of facilities or benefits to the members for a consideration, it does not automatically bring the activity in the course or in furtherance of business. In view of this, a service by society to its members cannot be covered under GST.

It is worth noting the startling similarity between the taxable service of "club or association" under pre-negative list regime of service tax contained in S. 65(105)(zzze) which reads as follows:

"To its members or any other person by any club or association relation to provision of services,

facilities or advantages for a subscription or any other amount"

Service tax levy on club or association was tested in various courts. Jharkhand High Court in the case of Ranchi Club Ltd.[2] and Gujarat High Court in the case of Sports Club of Gujarat Ltd.[3] has held that the "Club or Association Service" so far as related to members' club and opposed to the mutuality concept is not Constitutionally valid. Further, the Hon'ble Mumbai Tribunal in a combined ruling in case of Matunga Gymkhana, Tahnee Heights Co-operative Housing Society & Mittal Tower Premises Co-operative society[4] which is maintained by the Hon'ble Bombay High Court[5], it has been held,

"on application of principle of mutuality, services provided by appellants to their respective members would not fall within ambit of taxable club or association service nor the consideration whether by way of subscription/fee or otherwise received therefore be exigible to Service Tax".

Though a co-operative society is a separate legal entity, still it can claim immunity on principles of mutuality if the relevant conditions are satisfied. Courts have extended the principle of mutuality even to incorporated entities such as Companies etc. The principle of mutuality applies to mutual concern or association wherein various persons come together and make contribution to funds which would be used for some common purpose which is mutually beneficial and receive back the surplus left out in the same capacity in which they have made the contributions. Therefore, the contributors and participants would be the same. The people come together not with the objective of doing any business but for mutual help. There is no question of profit as the contributors and participants are the same. The principle of mutuality and its advent in tax laws is tested by many courts some prominent judgments are as follows:

- In *State of West Bengal vs. Calcutta Club Limited [2016] 96 VST 20 (SC)* held as under:

Before we proceed further, it is necessary to appreciate the doctrine of mutuality in proper perspective. The said doctrine or the general law relating to mutual concern is predicated on the principle enunciated in Styles vs. New York Life Insurance Company by Lord Watson in the following words:

"When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities or of capital sums, to some or all of them, on the occurrence of events certain or uncertain, and stipulate that their contributions, so far as not required for that purpose, shall be repaid to them, I cannot conceive why they should be regarded as traders, or why contributions returned to them should be regarded as profits."

- The Hon'ble Supreme Court in *Commissioner of Income-tax vs. Bankipur Club Ltd. [1997] 226 ITR 97 (SC)* held as under

"We heard the counsel. The following vital aspects should be borne in mind in adjudicating the question that arises for consideration in this batch of 16 appeals (covered by Groups A to D). The revenue is the appellant in all the appeals. The respondents in all the appeals are 'Members' Clubs'. They are also called 'social action groups'. They are all companies, registered under section 25 of the Companies Act, 1956 - 'non-profit companies'. The respondents are assessees to income-tax. They claimed exemption on their 'surplus receipts' on the ground that they are 'clubs' - a species of mutual undertaking, and do not carry on any 'trade or business'. They do not earn any profit. The income received by the clubs by extending facilities to non-members is not in issue

2 2012(26) STR (Jhar) – the Hon'ble Supreme Court has admitted departmental appeal against this decision

3 2013(31) STR 645 (Guj401)

4 [2015] 64 taxmann.com 78 (Mumbai - CESTAT)

5 2015 (40) STR 453 (Bombay)

in this batch of appeals. According to the revenue, even the surplus receipts of the Clubs by affording facilities to its members, is 'income' and so, taxable. That is the sole question arising for consideration in this batch of appeals.

The doctrine now has application in three areas. First, it applies to mutual insurance companies; secondly, it applies to certain municipal undertakings and, thirdly, to members' clubs, and mutual associations generally, whether incorporated or unincorporated, except registered industrial and provident societies...."

It should be noticed that in the case of 'mutual society or concern' (including a 'Members' Club'), there must be complete identity between the class of contributors and the class of participators. The particular label or form by which the mutual association is known, is of no consequence.

In the light of the above findings, it necessarily follows that the receipts for the various facilities extended by the clubs to its members, as stated hereinabove, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, cannot be said to be 'a trading activity'. The surplus – excess of receipts over the expenditure - as a result of mutual arrangement cannot be said to be 'income' for the purpose of the Act".

- The Hon'ble Bombay High Court in case of *Mittal Court Premises Co-operative Society Ltd. vs. ITO [2010] 320 ITR 414 (Bom.)* held as under :

"We have referred to the bye-laws of both, the Mittal Court Premises Co-operative Society Ltd. and Maker Chambers-III Premises Co-operative Society Ltd. The bye-laws are nothing but the contract between the Society and the member. Under these bye-laws, it is the member who has to make the payment. Any inter-se arrangement between the incoming members and the transferee is irrelevant in so far as the society is concerned. There is an agreement by which the amount is paid by the transferee. In so far as society is concerned, even if receipt is issued in the name of transferee it is the nature of admission fee which could be appropriated, only on the transferee being admitted. Merely because the amount may be appropriated earlier, it will not loose the character of the amount being paid by a member. In these circumstances, the identity of the contributor and beneficiary being satisfied and considering the provisions of Maharashtra Co-operative Societies Act and Rules framed thereunder, surplus can be disposed of in favour of the members only or for the objects for which they may specify. As held by us in Income Tax Appeal No. 931 of 2004 the same reasoning will apply to the appellants/petitioners before us. In these circumstances, question (a) as framed has to be answered in the negative in favour of the assessee and against the Revenue."

It is relevant to note there no fiction is created under the GST law to tax transactions covered by mutuality principle whether in case of incorporated or unincorporated entities. The entire activity of the CHS is covered by mutuality principle. The stray supply cannot be treated as to be in the course or furtherance of business.

Exemptions under GST Law for societies

Having noted that provision of service (sic) by a co-operative society to the member is not covered under GST, we nevertheless touch up to certain exemptions provided by the law and the liability in case of certain collections by the society. First, we take up the exemption up to ₹ 5,000/- per month per member for sourcing of goods or services from a third person for common use of its members in a society or a residential complex as provided in Notification No. 12/2017-CT (Rate) dated 28th June, 2017. The exemption applies only in case of sourcing of goods or services from a third person for the common use of the members. Further, the exemption is applicable only in case of residential societies and not commercial or industrial societies. Further the way the notification is worded it is applicable up to the amount (₹ 5,000) charged from a member per month meaning thereby that charges up to ₹ 5,000/- is exempted and if the amount is higher, such excess is taxable. However, the department as in case of similar notification under Service Tax takes a view that the exemption is applicable only in case the amount charged is ₹ 5,000/- or less per month per member, meaning that if the amount charged is ₹ 5,001/- no exemption is available.

In this context it is important to note that providing an exemption does not signify that there is a levy[6]. In other words, the exemption do not pre-suppose a levy. Hence, in view of the writer the exemption provided under the notification is infructuous.

Concept of pure agent

Further, it is also important to take note of principles of "pure agent" as contained under the valuation rules. Therefore, subject to the conditions specified in the rules any amount received from the member which is expended on actual basis, the same shall not be included in value of taxable supply under GST.

Chargeability of various receipts

Attention is drawn to FAQ on levy of GST on supply of services to the co-operative society wide Letter F.No.332/04/2017-TRU which enumerate the kind of supply of services as liable to tax. The said FAQ state that property tax, water tax, NA tax, electricity charges (not generated by the society's generator) collected on actual basis is not liable to tax. The said FAQ goes on to state that sinking fund, repairs and maintenance fund, car parking charges, non-occupancy charges, interest for late payment would attract GST. However, in view of the writer, collection of any fund without a definite promise of provision of service *qua* members should not be liable to tax as *quid-pro-quo* is an important element for levy of tax.

Applicability of GST on Religious Trust

A religious trust is registered as Public Charitable Trust and generally exempted under S.12AA of Income-tax Act. Such trusts definitely cannot be said to have business element. In view of the writer, the principle object of the trust is spreading the spirituality and the message of the Almighty. These trusts may be having receipts of renting of the premises in the precincts like prayer halls, sale of puja samagri, prasad, idols of Gods, religious texts etc. Many trusts have dharamshalas/musafirkhana, bhojanshala, pathshala and recover certain amounts as fees or otherwise. All these charges can be said to be the incidental or ancillary to the main object and hence out of the tax net. Further, donation received in cash or kind including corpus or otherwise shall not be liable to tax. Sale of jewellery etc. received by way of donation may not be liable to tax on the same ground.

Any donation received to perform religious rituals would not be liable to tax.

A question may arise for donation received against naming of hall etc. Though in view of writer, this can also be regarded as incidental to main objective of propagation of religion, a view can be taken that in case of donations with pre-condition of such naming there may be a liability as there being *quid-pro-quo* of such donation.

<u>In relation to religious trusts, the following services are specifically exempted by notification no. 12/2017-CT (Rate) (supra):</u>

- Conduct of religious ceremony
- Renting of precincts of religious place for general public
- Renting of rooms below ₹ 1,000/- per day
- Renting of premises, community hall, kalyanamandapam or open area below ₹ 10,000/- per day.

6 Larsen & Toubro 2015 (39) STR 913 (SC)

- Renting of shops or other spaces for business or commerce below ₹ 10,000/- per month.
- Services by any person for conduct of religious ceremony is not liable to tax.

It is worth noting that no exemption is bestowed in relation to supply of goods like sale of prasad, books, idols etc.

Conclusion

On above background the co-operative societies, NGOs are not required to take registration, if they do not have taxable supply. However, in case they are required to take registration, payment of GST under reverse charge for specified services prescribed u/s.9(3) except in case of Goods Transport Agency would not be applicable. However, purchase of goods and services from unregistered persons as prescribed u/s.9(4)would be liable to tax [this relaxation is presently given up to 31st March 2018].

It is pertinent to note that sometimes religious trusts have number of properties having major source of receipts as rent. In such cases, it is advisable to take a view that such receipts are in the nature of taxable supply.

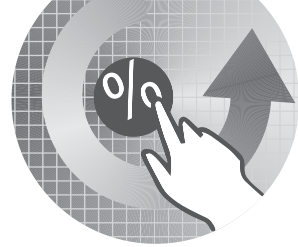
The article sum up in general what constitute business under the GST law to qualify as supply and liable to tax. The principles laid down would apply to the co-operative housing societies, religious trusts, charitable trusts and other non-profit organisations. In the second part of the article we shall discuss the applicability of GST to the services by charitable trust and other non-profit organisations with specific reference to educational institutions and hospitals run by them.

Learning gives creativity, Creativity Leads to Thinking, Thinking Provides Knowledge, Knowledge makes you great.

— Dr. A. P. J. Abdul Kalam

The best brains of the nation may be found on the last benches of the classroom.

— Dr. A. P. J. Abdul Kalam



CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

The authors have tried to cover GST Updates pertaining to law points in particular. The notifications, circulars, orders relating to extension of various statutory due dates are not covered herewith.

A. Central Goods & Services Tax (CGST)

1. Extension of LUT facility to all exporters (Notification No. 37/2017 dated 4-10-2017)

The facility of export under LUT has been now extended to all registered persons who intend to supply goods or services for export without payment of IGST except those who have been prosecuted for any offence under the CGST Act or the IGST Act or any of the existing laws and the amount of tax evaded in such cases exceeds ₹ 250 lakh. The LUT shall be valid for the whole financial year in which it is tendered.

LUT provision shall *mutatis mutandis* apply in respect of zero-rated supply of goods or services or both made by a registered person (including a Special Economic Zone developer or Special Economic Zone unit) to a Special Economic Zone developer or Special Economic Zone unit without payment of integrated tax.

2. Handicraft goods (Notification No. 38 /2017 dated 13-10-2017)

Any person making inter-state taxable supplies has to compulsorily require registration irrespective of turnover.

From 14th September 2017, exemption granted to casual taxable person making Inter-state taxable supply of handicraft goods from obtaining registration. The scope of handicraft goods has been enlarged from 13th October, 2017 by adding goods such as textiles, chains, stich, crewel, namda, wicker, toran, articles made of shola.

3. Refund procedures (Notification No. 39 /2017 dated 13-10-2017)

State tax officers have been authorised to issue refund as per Section 54 and Section 55 of CGST and IGST Act. However, these officers are not allowed to sanction refund of IGST paid on goods exported out of India.

4. No tax on advances received against goods (Notification No. 40/2017 dated 13-10-2017)

The time of supply in case of supply of goods has been amended for the persons whose turnover in preceding financial year does not exceed INR 1.5 crore or turnover in the financial year in which he has taken registration does not exceed INR 1.5 crore. In such cases, the condition of paying GST on advances received against goods has been done away with. Thus in case of supply of goods for such persons, the GST is now payable based on issue of invoice.

However, it is worth noting that similar amendments have not been made in chapter pertaining to time of supply of services and therefore GST would continue to be payable if advances are received against services.

5. Amendment to CGST Rules – Ninth Amendment Rules (Notification No. 45/2017 dated 13-10-2017)

- The time limit for filing of stock declaration in case of composition dealer in Form GST CMP 02 has been extended up to 31st March 2018.
- Person supplying taxable as well as exempted goods or services or both to unregistered person are now allowed to issue 'single invoice-cum-bill of supply'
- Insurance, banking companies, financial institutions are now allowed to issue consolidated invoice for services provided during the month at the end of the month.
- Other procedural changes have been carried out in various GST forms.

6. Composition scheme limit (Notification No. 46/2017 dated 13-10-2017)

The aggregate turnover limit for persons desirous of opting for composition scheme has been increased from INR 75 lakh to INR 1 crore. For the North Eastern States, such aggregate turnover limit has been enhanced from INR 50 lakh to INR 75 lakh.

Exempt services (interest received on bank deposits) should not be considered in determining limit of aggregate turnover.

The option once exercised shall become operational from the first day of the month immediately succeeding the month in which the option to avail the composition scheme is exercised.

7. Amendment to CGST Rules – Tenth Amendment Rules (Notification No. 47/2017 dated 18-10-2017)

Rule 89 of CGST Rules has been amended so as to provide for refund filing application to following typs of persons:

- recipient of deemed export supplies; or
- supplier of deemed export supplies in cases where the recipient does no avail of input tax credit on such supplies and furnishes an undertaking to the effect that the supplier may claim the refund".

Further, minor amendments have been carried out in Form GST RFD-01 to include cess column.

8. Deemed Exports (Notification No. 48/2017 dated 18-10-2017)

The following categories of persons are categorised as deemed exporters:

- Supply of goods by a registered person against Advance Authorisation
- Supply of capital goods by a registered person against EPCG Authorisation
- Supply of goods by a registered person to EOU
- Supply of gold by a bank or Public Sector Undertaking specified in the Notification No. 50/2017-Customs, dated the 30th June, 2017 (as amended) against Advance Authorisation.

9. Refund condition for deemed exporters (Notification No. 49/2017 dated 18-10-2017)

In order to claim refund as per Rule 89(2) of CGST Rules, the following further conditions has been notified for deemed exporters:

- Acknowledgment by the jurisdictional Tax Officer of the Advance Authorisation holder or EPCG Authorisation holder, as the case may be, that the said deemed export supplies have been received by the said Advance Authorisation or EPCG Authorisation holder
- Or a copy of the tax invoice under which such supplies have been made by the supplier, duly signed by the recipient EOU that said deemed export supplies have been received by it
- An undertaking by the recipient of deemed export supplies that no input tax credit on such supplies has been availed of by him
- An undertaking by the recipient of deemed export supplies that he shall not claim the refund in respect of such supplies and the supplier may claim the refund.

10. Amendment to CGST Rules – Eleventh Amendment Rules (Notification No. 51/2017 dated 28-10-2017)

Vide the said notification, Rule 96 & Rule 96A are amended in order to provide for filing of 'Table 6A of Form GSTR-1' for the purpose of claiming GST refund of tax paid on export transactions & supplies to SEZ. The details filed in Table 6A will be auto populated in GSTR-1.

Further, the said details would be forwarded to relevant authorities for processing of refund claims as per Rule 96

B. Central Goods & Services Tax (CGST) Rate Changes

1. GST Rate Change – Services (Notification Nos. 31/2017 & 32/2017- Rate dated 13-10-2017)

As decided in 22nd GST Council meeting, changes to GST rate of various services have been reduced such as certain works contracts, transport of passengers by motor vehicles, renting of motor cab, leasing of motor vehicles, services of job work, printing of goods.

2. Reverse Charge Mechanism – Services (Notification No. 33/2017 – Rate dated 13-10-2017)

Reverse Charge Mechanism is extended to 'Supply of services by the members of Overseeing Committee to Reserve Bank of India'. In such cases, GST liability has to be discharged by RBI.

3. GST Rate Change – Goods (Notification No. 34/2017 – Rate dated 13-10-2017)

As decided in 22nd GST Council meeting, changes to GST rate of various goods have been reduced such as certain mangoes, khakras, namkeens, medicaments, waste, scrap, biomass briquettes, sewing threads, poster colours, plain shaft bearings, etc.

4. Exempted goods (Notification No. 35/2017 – Rate dated 13-10-2017)

Few goods have been added to the existing list of exempted goods such as duty credit scripts, supply of goods by a Government entity to Central Government, State Government, Union Territory, local authority or any person specified by Central Government, State Government, Union Territory or local authority, against consideration received from Central Government, State Government, Union territory or local authority in the form of grants.

5. Reverse Charge Mechanism – Goods (Notification No. 36/2017-Rate dated 13-10-2017)

Reverse Charge Mechanism is extended to supply of Used vehicles, seized and confiscated goods, old and used goods, waste and scrap by Central Government, State Government, Union Territory or a local authority.

6. GST Rate Change – Leasing of Motor Vehicle and sale of such leased Vehicle (Notification No. 37/2017 – Rate dated 13-10-2017)

GST on Leased Motor vehicles (Chapter 87) was charged at 43% [GST – 28% + Cess 15%] prior to 13-10-2017. This rate of tax has been now reduced by providing abatement of 35% from rate of tax i.e. GST on such leased car would be 65% of the applicable GST (28%) + Cess rate (15%) = 27.95% subject to following conditions –

(i) Motor Vehicle purchased by lessor prior to 1st July, 2017 and supplied on lease before 1st July, 2017;

(ii) This reduced rate would be applicable for a period of 3 years with effect from 1st July, 2017 i.e., till 1st July, 2020.

When such leased motor vehicle is sold / disposed of, it would be taxed at 65% of the applicable rate of GST + Cess i.e. 27.95% subject to following conditions –

(i) The supplier of Motor Vehicle is a registered person.

(ii) Such supplier had purchased the Motor Vehicle prior to 1st July, 2017 and has not availed input tax credit of Central Excise duty, Value Added Tax or any other taxes paid on such vehicles.

7. RCM-URD purchases (Notification No. 38/2017 – Rate dated 13-10-2017)

The liability to discharge GST under reverse charge on URD purchases [Section 9(4) of GST Act] has been done away with effect from 13-10-2017. However, GST under reverse charge for all other items continues i.e. in cases of transport payment, import ocean freight, lawyer payment, sponsorship payments, etc.

8. GST Rate Change (Notification No. 39/2017 – Rate dated 18-10-2017)

The said notification seeks to reduce GST rate on food preparations put up in unit containers and intended for free distribution to economically weaker sections of the society under a programme duly approved by the Central Government or any State Government.

9. Merchant Exports (Notification No. 40/2017 – Rate dated 23-10-2017)

A registered supplier may charge a total GST of 0.1% (CGST – 0.05% + SGST – 0.05%) to registered recipient if the said goods are exported by the recipient within a period of 90 days subject to terms and conditions as laid down under the notification. The said notification comes into effect from 23-10-2017

C. CIRCULARS

1. Circular 08/2017 dated 4-10-2017

Further clarifications are issued regarding issues pertaining to issuance of Bond and Letter of Undertaking. However, since the condition of LUT is extended to everyone *vide* Notification No. 37/2017, the said circular may be of limited use as on date.

2. Circular 09/2-017 dated 18-10-2017

The said Circular clarifies the Authorised Officer for the purpose of enrollment of Goods and Services Tax Practitioner. It is also clarified that the applicant shall be at liberty to choose either the Centre or the State as the enrolling authority.

3. Circular 10/2017 dated 18-10-2017

Clarification has been issued regarding issues pertaining to movement of goods on supply on approval basis (for example jewellery). It is further clarified that all such supplies, where the supplier carries goods from one State to another and supplies them in a different State, will be inter-state supplies and attract IGST in terms of Section 5 of the IGST, 2017.

4. Circular 11/ 2017 dated 20-10-2017

Clarification has been issued with respect to issues regarding taxability of printing contracts such as whether supply of books, pamphlets, brochures, envelopes, annual reports, leaflets, cartons, boxes etc., printed with design, logo, name, address or other contents supplied by the recipient of such supplies, would constitute supply of goods falling under Chapter 48 or 49 of the First Schedule to the Customs Tariff Act, 1975 (51of 1975) or supply of services falling under Heading 9989 of the Scheme of Classification of Services.

5. Circular 12/2017 dated 26-10-2017

Clarification has been issued regarding applicability of GST on the superior kerosene oil [SKO] retained for the manufacture of Linear Alkyl Benzene [LAB].

6. Circular 13/2017 dated 27-10-2017

Clarification has been issued regarding classification issued in relation to cut pieces of fabrics and unstitched salwar suits.

Similar amendments have been carried out under IGST Act, SGST Act and Compensation Cess. The same being repetitive in nature are not covered/mentioned specifically.

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law No. 1

[Before the National Company Law Appellate Tribunal, New Delhi]

http://nclat.gov.in/final_orders/Principal_Bench/2017/company/21092017AT1331392017.pdf

Cyrus Investments Pvt. Ltd. & Anr. vs. Tata Sons Ltd. & Ors.

The words "Share capital" as per section 244 would have to be read in conjunction with section 241 and should be read as the "class of members" and thus issued share capital could mean either "preference share capital" or "equity share capital "or collectively both.

Brief facts

M/s. Cyrus Investments Pvt. Ltd. and Sterling Investment Corporate Pvt. Ltd. ("Appellants") have filed two separate applications before the National Company Law Appellate Tribunal ("NCLAT") against the orders of National Company Law Tribunal, Mumbai Bench. ("NCLT").

The facts are as follows:

1. Appellants are holding 2.17% of total issued equity share capital of ₹ 40.41 crores of the responded.

2. They do not hold any preference shares in the total issued preference share capital of ₹ 294 crores in the respondent.

3. Appellants consist of two members only.

4. Appellants have filed the petition under sections 241, 242 and 243 of the Companies Act, 2013 ("Act") and Rules made there under before the NCLT for alleged oppression and mismanagement against the member by the respondent.

5. Appellants have filed a petition for waiver of conditions under proviso to section 244 for relaxing the conditions as to requirement of minimum shareholding of 10% of issued share capital for filing an application under section 241 for oppression and mismanagement.

6. NCLT has rejected for an interim relief sought by the appellants but not decided on the maintainability of the petition for oppression and mismanagement under section 244 of the Act.

7. On appeal before the NCLAT, it was directed that NCLT should decide the question of maintainability first, if it is in negative, then to consider the waiver petition from compliance of conditions mentioned under section 244 of the Act. If waiver is allowed, then to decide the petition on merit.

8. NCLT *vide* its order hold that the petition by the appellants is not maintainable. NCLT also reject the waiver petition.

The following two questions are placed for NCLAT.

a. Whether the petition under sections 241 and 242 of the Act is maintainable? And

b. In case of above question is negative, then whether the appellants have made a case for waiver of all or any requirements as specified in Clause 1(a) of section 244 of the Act.

The following submissions are made by the appellants for their waiver petition.

1. Act has created and recognises classes of members under section 2(55), Chapter IV as to share capital *vide* sections 43, 47, 48 and 49, sections 87, 88 etc.

2. Scheme of sections 241-244 are self-contained code dealing with the subject of "Oppression and Mismanagement."

3. There is distinction as to provisions of sections 241(a) and 241(b) as to protection of the rights and interest of the category of persons.

4. The words "Share capital" as per section 244 would have to be read in conjunction with section 241 and should be read as the "class of members".

5. The reference to "Issued share capital" in section 244 has only to refer to the "Relevant share capital".

6. The issued share capital could mean either "Preference share capital" or "Equity share capital "or collectively both.

7. If the intention of legislature was to give same meaning to Issued share capital as "Total share capital" while dealing with "not less than one-tenth of the total number of its members..." they would have given same indication and it cannot be referred to as simply an omission on their part.

8. Unlike section 87 of the Companies Act, 1956, which restrained the voting rights of equity shareholders to equity share capital and a preference shareholders to preference share capital, section 47 of the Act, grants the right to vote on every resolution placed before the company.

9. Reliance was also placed on the decision of Hon'ble Supreme Court in *"Infrastructure Leasing and Financial Services Limited vs. BPL Limited" 2015 (3) SCC 363,* wherein the concept of class noticed and reference to Palmer's Treaties on Company Law as to what constitutes a class.

10. If the term "Issued share capital" is considered, then for making an application, it would require a holding of at least 81% equity shares in the company to be eligible to maintain action under section 241. Also as the main intention of section 241 is to protect minority against oppression & mismanagement, "class of members" has been specifically included under section 241(1)(b) of the Act.

11. Reference to Hon'ble Supreme Court decision in *"Krishna Kumar versus State of Rajasthan and Others, (1991) 4 SCC 258"* was referred to suggest that new scheme by reference to clause brought into section 241 cannot be ignored as an insignificant change.

12. Section 241 and section 244 will need to be read together and are not mutually exclusive which is moreso when section 245 of the Act on Class Action contains the same parameters as contained in section 244 and specifically deals with "class of members".

13. Decision in *"Northern Projects Limited vs. Blue Coast Hotels and Resorts Ltd. and Others"* relied by NCLT have to be read with earlier Companies Act, 1956.

The following submission are made from respondent:

1. For the purpose of making an application, section 241 provides three categories of members having right to approach NCLT. In view of this, section 244 allows those who hold specified numerical or shareholding numbers. The Parliament did not want all members of the company to armed with right to make an application under section 241.

2. While the "Issued share capital" includes both "Equity and preference share capital" various provisions of the Act make it clears that it includes both capital.

3. Section 244(1) of the Act being *pari materia* to section 399(1) of the 1956 Act, the interpretation of "Issued Share Capital" is to be applied as held by Hon'ble High Court of Bombay and affirmed by *Hon'ble Supreme Court in Northern Projects Limited vs. Blue Coast Hotels and Resorts Ltd. and others.*

4. Reliance was also placed on Hon'ble Supreme Court in *"J. P. Srivastava & Sons (P) Ltd. vs. Gwalior Sugar Co. Ltd". (2005) 1 SCC 172* in support of the plea that the word "issued Share Capital" includes both equity and preference share capital.

5. Wherever the Parliament thought fit to refer to "class" or "issued equity share capital" it has done so expressly like section 236 and section 48 of the Act.

6. Various case laws cited in support of the above submission.

Judgment

NCLAT has set aside the order of the NCLT dated 17th April, 2017 and grant "waiver" to the appellants to enable them to file application under section 241 of the Act. NCLAT has analysed each of arguments forwarded by both parties. It also reviewed the list of shareholdings both of equity and preference share capital. It has observed that by as per the list, only two members out of 51 shareholders can file an application under section 241 of the Act. Thus, except they join together, none of remaining 49 shareholders can file an application under section 241 for Oppression & Mismanagement. Thus, it is only in the hand of two major shareholders. It has noted that this is one of the "exceptional and compelling situations" and merit "waiver". The overall value of the company is over ₹ 6 lakh crores and interest of appellants will be over ₹ 1 lakh crore which means they hold 1/6th of the said valuation. Whereas preference share has value of ₹ 291 crore and they do not have voting rights except in certain circumstances. This factor is also to be considered. NCLAT also reviewed the Article 121-A of the Articles of Association of the respondent company and noted that it has complete control over decision making and affairs of all "Tata Group Companies".

Experience is the only teacher we have. We may talk and reason all our lives, but we shall not understand a word of truth until we experience it ourselves.

— *Swami Vivekananda*

Our own selfishness makes us the most arrant cowards; our own selfishness is the great cause of fear and cowardice.

— *Swami Vivekananda*

CA Vijay Shah & CA Mayur Shah

CORPORATE LAWS – RECENT DEVELOPMENTS

Meaning of Control under Regulatory Laws – Companies Act, SEBI Takeover Code, Competition Act and FEMA under Corporate Law

Introduction

While commencing or operating any business unit by an individual, group or an enterprise as a promoter, having control over the business is of paramount importance as it provides an ability to take ownership over the operational or strategic decision-making processes. Control gives a promoter major influence over the actions of a business unit. Control over an enterprise can manifest in many ways. For example, it grants a promoter leverage to increase shareholding in an enterprise in the event of a merger or acquisition and structure a deal for its beneficial interest. The regulatory authorities would like to keep a check to ensure that controlling rights of promoters are not misused at the cost of other stakeholders and of the economy at large.

Control assumes importance for owners, regulators and various stakeholders. Control is best determined on a case-to-case basis and what amounts to control is most often a subjective test.

Let us examine the dictionary meaning of Control. Black's Law Dictionary defines the term *"To exercise restraining or directing influence over. To regulate, restrain, dominate, curb, to hold from action, overpower, counteract, govern; Power or authority to manage, direct, superintend, restrict, regulate, govern, administer, or oversee. The ability to exercise a restraining or directing influence over something"*.

The above definition suggests that a person has control even if he is not directly managing the other and is in a position to influence or restrain or regulate others.

International context

For the purpose of corporate actions such as takeovers and acquisitions, different countries around the world have different criteria to determine as to what amounts to 'control'. In countries such as Australia, and UK, the change of control is considered to be the same as acquisition of voting rights above **specified thresholds** irrespective of whether such holdings confer de facto control, whereas in countries such as Japan and USA, control has **not been defined.**

In few countries such as France, Norway and Spain, an enterprise is deemed to be in control of a company, if it has the right or exercises control, directly or indirectly, **over the majority of voting rights** at the general meetings of the company or **has the ability to control the composition of a majority of the board members** of the company.

While, in countries such as China and Denmark, control is deemed to be exercised not only through voting rights or appointment of majority of the board members, but also through the **ability to exercise influence over the company's policies or its shareholder meetings,** even if the entity holds voting rights below specified thresholds.

Indian context

In India, different definitions of 'control' are provided under different Acts and Regulations to give effect to the intent of the respective statute by respective regulators. Let us analyse meaning of control under selected corporate laws and attempt to evaluate the similarities and differences amongst them.

Companies Act, 2013 ("2013 Act")

Section 2(27) of the 2013 Act – *"control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.*

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations")

Regulation 2(1)(e) of Takeover Regulations – *"control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:*

***Provided** that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position.*

Analysis

Definition of 'control' under 2013 Act and Takeover Regulations are inclusive in nature and are similar whereby, control may be exercised through following modes, directly or indirectly:

- right to appoint majority of the directors or
- to control the management or policy decisions
  - o exercisable by a person or persons acting individually or in concert,
  - o by virtue of their shareholding or management rights or shareholders agreements or voting agreements or
  - o in any other manner

The said definition is an inclusive of right to:

- appoint a majority of directors;
- control the management
- control the policy decision.

To sum up, the term control could be understood with regard to:

- Majority voting rights;
- *De facto* (i.e. actual control);
- Right to appoint or control the management body; and
- Power to control or influence the policy decisions.

Competition Act, 2002 ("Competition Act")

Definition of 'control' is defined in Explanation (a) to section 5 of the Competition Act, which deals with Combinations, as under:

"Explanation — For the purposes of this section,—

(a) "control" includes controlling the affairs or management by—

i. one or more enterprises, either jointly or singly, over another enterprise or group;

ii. one or more groups, either jointly or singly, over another group or enterprise;"

Definition of control under the Competition Act is specific to Section 5 dealing with Combination of enterprises by way of acquisition of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service with monetary threshold of assets or turnover.

Foreign Exchange Management Act, 1999

'Control' has been defined in Regulation 14(1)(ia) of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ("FEMA Regulations") as under:

'Control' shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements. For the purpose of Limited Liability Partnership (LLP), 'control' shall mean right to appoint majority of the designated partners, where such designated partners, with specific exclusions to others, have control over all the policies of LLP.

Foreign Direct Investment Policy ("FDI Policy")

'Control' shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements. For the purposes of LLP, 'control' will mean right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of the LLP.

The definition under FEMA Regulations and FDI Policy are same. They are similar to the one stated under 2013 Act and Takeover Regulations to the extent mentioned below:

- right to appoint a majority of the directors or
- to control the management or policy decisions.

Under FEMA Regulations and FDI Policy, such power is by virtue of shareholding or management rights or shareholders agreements or voting agreements whereas under the 2013 Act and Takeover Regulations, it also includes powers *vide* 'in any other manner'.

Unlike other laws, the FEMA Regulations and FDI Policy also defines control over the LLP whereby control shall mean the right to appoint majority of the designated partners who have control over all the policies of the LLP, with specific exclusion to others. The Limited Liability Partnership Act, 2008 does not have express definition of 'control'; however in terms of residuary provisions, it relies on 2013 Act for the purpose of defining term control.

Below table gives similarities and difference in term 'control' under aforesaid statutes / regulations:

Particulars	**2013 Act**	**Takeover Regulations**	**FEMA Regulations and FDI Policy**	**Competition Act**
Appoint majority of the directors	√	√	√	X
Controlling the management or policy decisions	√	√	√	X

Particulars	2013 Act	Takeover Regulations	FEMA Regulations and FDI Policy	Competition Act
Controlling the affairs	X	X	X	√
By virtue of • shareholding or management rights or shareholders agreements or voting agreements	√	√	√	X
• any other manner	√	√	X	X
Relevant factor	Right to appoint a majority of board members or controlling the "management or policy decisions"			Controlling "the affairs or management"
Intent of law	To regulate the functioning of corporate sector and to promote good corporate practices	To regulate takeovers in of listed companies where public are interested and to protect the interests of investors in securities market and for matters connected therewith or incidental thereto.	To attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth.	To implement and enforce competition policy and to prevent and punish anti-competitive business practices by firms and protect the interest of the consumers and ensure freedom of trade in Indian markets.

It is apparent from above that different laws have different intent and definition of 'control' is applied to implement the objective and principles of the law. It would be observed from the above definitions that all are inclusive in nature, thereby gives rise to subjective interpretation depending upon the facts and circumstances of case considering the intent of the law. The expression "affairs and management" may be of much wider connotation than the expression "management or policy decisions". There could be a situation wherein by controlling "the affairs and management" in a company, a person may be in a position to control "management or policy decisions" but it may not always be the case.

Recent developments

In March 2016, Securities and Exchange Board of India (SEBI) had issued a Discussion Paper on "Bright-line Tests for Acquisition of Control under SEBI Takeover Regulations" and had proposed the tests for determining control under takeover regulations.

SEBI had proposed two options-framework for protective rights and adoption of numerical threshold. For protective rights, veto rights not amounting to acquisition of control may be protective rather than participatory in nature. The test is to check whether the acquirer is in the driving seat. For numerical threshold, it had proposed to fix 25% voting rights as threshold lever for trigger of control for Indian listed companies.

SEBI received numerous comments from various stakeholders including the Ministry of Corporate Affairs ("MCA"), Reserve Bank of India (RBI), industry bodies, intermediaries, advocates and investors. But since the responses were mixed, no particular option garnered overwhelming support among the stakeholders.

MCA and other stakeholders have opined that changing the current definition of 'control' may reduce the regulatory scope and may be prone to abuse and that the current definition of 'control' be retained and it would be more appropriate to take decisions on a case-to-case basis.

One may also refer when the Justice Bhagwati Committee (JBC) – which was constituted in 1995 to review the earlier Takeover Regulation – recommended a broad definition of control and opined that it should be left to the Regulator to decide whether there has been an acquisition of control on the basis of facts of each case. The Takeover Regulations Advisory Committee, in its report issued in 2010 also reiterated the view of the committee.

Recently, on 8th September, 2017, SEBI issued a Press release stating that the relevant issues were examined intensively and considering the current regulatory environment, it decided to continue with the practice of ascertaining acquisition of 'control' as per the extant definition in the Takeover Regulations.

Control or not

In the matter of Subhkam Ventures (I) Pvt. Ltd., wherein SEBI had taken a view that the rights conferred upon the acquirer, through the agreements, amounted to 'control' over the target company. Hon'ble Securities Appellate Tribunal ("SAT"), in its judgment dated January 15, 2010, rejected SEBI's view stating that none of the clauses in the agreements, individually or collectively, demonstrated control in the hands of the acquirer.

Hon'ble SAT had observed that:

- Control, according to the definition, is a proactive and not a reactive power
- Control is a power by which an acquirer can command the target company to do what he wants it to do and controlling a situation by taking the initiative
- Control is a positive power whereby the acquirer is proactive
- Power by which an acquirer can only prevent a company from doing what the latter wants to do, and when an acquirer is only reacting rather than taking the initiative should not amount to control.
- The test really is whether the acquirer is in the driving seat. Affirmative vote cannot confer control over the day-to-day working of the company. Affirmative vote of the investor in these matters is necessary for protecting its investment….Such fetters fall far short of the existence of "control" over the target company

The said matter was then referred to the Hon'ble Supreme Court, where it stated that in changing circumstances, it is in the interest of justice to dispose of the appeal by keeping the question of law open and clarified that the impugned order passed by the SAT will not be treated as a precedent.

Regulators perspective

Since there is no exact parity in the definition of 'control' it tends to create situations whereby different regulators have different views on what amounts to control.

The deal between Jet Airways (India) Limited ("Jet") and Etihad Airways PJSC ("Etihad") showed how different regulators interpreted control and how regulators co-ordinated with each other to arrive at common ground.

This transaction saw various issues and hurdles. The Government of the United Arab Emirates ("UAE") sought protection of UAE's in¬vestments in India as regulatory approvals were hard to come through, on grounds of 'control'.

Concerns were raised by SEBI and the erstwhile Foreign Investment Promotion Board ("FIPB") in India on the structure of the board and transaction documents. Pursuant to this, the parties agreed to revise the initial investment agreement ("IA"), shareholders agreement ("SHA") and commercial co-operation agreement ("CCA") and entered into an amendment agreement to the IA, amended and restated SHA and amended and restated CCA.

Jet had filed for the requisite approval from FIPB for the preferential allotment of shares to Etihad, as any investment into a domestic airline by a foreign airline was subject to approval by FIPB. Initially FIPB deferred the proposal due to apprehensions regarding the effective control of the target passing to Etihad, which would have been a violation of FDI Policy. While deferring the proposal, FIPB sought clarifications from Jet and Etihad on the ownership and effective control of Jet post consummation of the Deal.

On submission of a revised proposal, FIPB approved, subject to conditions such as approval of the Government of India will be required in case of amendment to shareholders' agreement or change in Etihad's shareholding.

In the present case, no open offer was made under the Takeover Regulations by Etihad as the parties were of the opinion that open offer thresholds under the Takeover Regulations were not triggered as a result of the Deal. As per the Takeover Regulations, such open offer must be at least for 25% of the total shares of the target company calculated as of the tenth date from the closure of the tendering period and after factoring all potential increases contemplated during the offer period.

SEBI scrutinised the deal to verify if Etihad acquired control over the Target or if it was acting in concert with the Promoters of Jet. After various submissions made by the parties to SEBI and amendments to Transaction Documents, SEBI concluded that the rights proposed to be acquired by Etihad do not prima facie appear to result in change of control and thus the provisions of the Takeover Regulations with respect to open offer do not get attracted. However, SEBI reserved its right to declare Etihad as a promoter if any other regulator or agency decides that Etihad is acquiring control over Jet.

Competition Commission of India (CCI) had observed that through transaction documents Etihad will have joint control over Jet especially over the assets and operations of Jet. Subsequent to CCI's ruling, SEBI revisited its interpretation of 'control' and served show cause notices on the promoters of Jet, alleging joint control over Jet by Etihad requiring an open offer under the Takeover Regulations by Etihad. After numerous submission and clarifications by parties, SEBI cleared the deal and dropped show cause notice for open offer.

Conclusion

Different minds may have different interpretations which may often lead to different perspectives. It is akin to a childhood story which said that 'a zebra is black with white strips on it or a zebra is white with black strips on it.'

While the term 'control' is defined differently in many statutes, regulators do interpret it keeping in mind the intent of the respective statute. Control also gives rise to consolidation under the Accounting Standards/Indian Accounting Standards. Thus, it becomes imperative to consider and evaluate its implication in current dynamic world during any acquisition or structuring of a deal. This is to ensure that while economic objective of the transaction is a priority, the laws of the land are also honoured.

CA Mayur Nayak, CA Natwar Thakrar &
CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circulars issued by RBI:

1. Investments by Foreign Portfolio Investors in Corporate Debt Securities – Review

The Masala Bonds are presently reckoned both under Combined Corporate Debt Limit (CCDL) for FPI in terms of Schedule 5 to Notification No. 20 – the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, and External Commercial Borrowings (ECBs) under the extant guidelines notified under Notification No. 3 – the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000.

On a review, and to further harmonise norms for Masala Bonds issuance with the ECB guidelines, RBI has announced that w.e.f. October 3, 2017, Masala Bonds will no longer form a part of the limit for FPI investments in corporate bonds but will form a part of the ECBs and will be monitored accordingly.

The amount of ₹ 44,001 crore arising from shifting of Masala Bonds will be released for FPI investment in corporate bonds over the next two quarters as follows:

Table 1 – Limit for FPI Investments in Corporate Bonds

		Amount (₹ crore)
1.	Current FPI limits for corporate bonds (including Masala Bonds)	2,44,323
	(a) of which Masala Bonds (including pipeline)	44,001
2.	FPI limit after shifting Masala Bonds to ECB (1-(a))	2,00,322
3.	Additional limit for Q3 FY18	27,000
4.	FPI limit for corporate bonds from 3 Oct. 2017 (2+3)	2,27,322
	of which reserved for investment by long-term FPIs in infrastructure	9,500
5.	Additional limit for Q4 FY18	17,001
6.	FPI limit for corporate bonds from January 01, 2018 (4+5)	2,44,323
	of which reserved for investment by long-term FPIs in infrastructure	9,500

An amount of ₹ 9,500 crore in each quarter will be available only for investment in infrastructure sector by long-term FPIs (i.e., Sovereign Wealth Funds, Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks).

The definition of 'Infrastructure' shall be the same as defined under the Master Direction on ECBs issued by the Reserve Bank of India. Long-term FPIs will continue to be eligible to invest in sectors other than infrastructure.

Reporting requirement in terms of paragraph 8 (additional e-mail reporting of RDB transactions for onward reporting to depositories) of A.P. (DIR Series) Circular No. 60 dated April 13, 2016 has been dispensed with. However, it should be noted that the reporting of RDBs will continue as per the extant ECB norms.

(The release of additional limit of ₹ 44,001 crore will increase FPI fund flow in corporate debt bonds and provide boost to the economy.)

(A.P. (DIR Series) Circular Nos. 5 & 6 dated 22nd September, 2017)

2. Investment by Foreign Portfolio Investors (FPI) in Government Securities Medium Term Framework

In terms of Schedule-5 to Notification No. 20 - the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, Foreign Portfolio Investors (FPI) are allowed to invest in Government Securities and the limits upto which such investments can be made are notified from time to time.

The limits for investment by FPIs for the quarter October-December 2017 is increased by INR 80 billion in Central Government Securities and INR 62 billion in State Development Loans. The revised limits are allocated as per the modified framework prescribed in the RBI/2017-18/12 A.P.(Dir Series) Circular No.1 dated July 3, 2017, and given as under:

Limits for FPI investment in Government Securities

₹ billion

Quarter Ending	Central Government securities			State Development Loans			Aggregate
	General	Long-Term	Total	General	Long-Term	Total	
Existing Limits	1877	543	2420	285	46	331	2751
December 31, 2017	1897	603	2500	300	93	393	2893

The revised limits will be effective from October 3, 2017. The operational guidelines relating to allocation and monitoring of limits will be issued by the Securities and Exchange Board of India (SEBI).

(This will increase FPI fund flow in Government Securities and provide boost to the economy.)

(A.P. (DIR Series) Circular No. 7 dated 28th September, 2017)

3. Risk Management and Inter-bank Dealings – Facilities for Hedging Trade Exposures invoiced in Indian rupees

In terms of para 6 under Section II (Facilities for Persons Residents Outside India) of the aforementioned master direction, non-residents are permitted to hedge the currency risk arising out of INR invoiced exports from and imports to India with AD Category-I banks in India.

On a review, RBI has now permitted the central treasury (of the group and being a group entity) of such non-residents to undertake hedges for and behalf of such non-residents with AD Category-I banks in India as per the existing Model I and Model II (annexed to the circular). The revised operational guidelines, terms and conditions are provided by way of annex to the circular.

(A.P. (DIR Series) Circular No. 8 dated 12th October, 2017)

4. Updated through FAQs

A. FAQs – Overseas Direct Investments

RBI Update on FAQs as on September 1, 2017 now contains new Question 62 in the FAQs on Overseas Direct Investments as under:

Q.62 Is development/construction (and thereafter, sale) of residential /commercial premises by an overseas Joint Venture (JV) or Wholly Owned Subsidiary (WOS) treated as real estate business under ODI regulations (FEMA Notification No. FEMA 120/RB-2004 dated July 7, 2004 as amended from time-to-time)?

Ans. No. In terms of regulation 5(2) read with Regulation 2 (p) of FEMA Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time-to-time, buying land for construction/development of residential/commercial premises (before selling) – as one integrated core activity, is not treated as real estate business activity.

Earlier update was on 12th April, 2017.

Refer https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=32&fn=5

B. FAQs – Money Changing Activities

RBI Update on FAQs as on September 29, 2017 now contains new Question 22 in the FAQs on Money Changing Activities as under:

Q.62 What is the position of Papua New Guinea Paper Banknotes?

Ans. As per the Public Notice (https://www.bankpng.gov.pg/wp-content/uploads/2014/08/Full-page_-potrait_Paper-Bank-Notes2.pdf) issued by Bank of Papua New Guinea on their website www.bankpng.gov.pg Papua New Guinea paper banknotes ceased to be legal tender on June 30, 2012 and only polymer banknotes are legal tender in Papua New Guinea. Further, Bank of Papua New Guinea has also shared the following range of serial numbers of banknotes which were never issued (and were sold to a recycler in Europe) and are therefore, not legal tender in Papua New Guinea:

Denomination	Prefix	Low	High
K2	ABJ – AJS	000001	003000
K10	AC – AY	030000	031000
	NBP – NES	160000	173000
K20	BPNG	0000001	3000000
K50	HTT – HUU	080000	090000
K100	BPNG	0000001	6000000

Earlier update was on 18th January, 2017

Refer https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=54&fn=5

C. FAQs – Issuance of Rupee Denominated Bonds Overseas

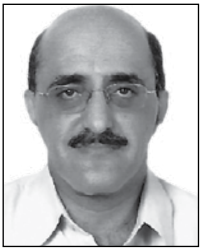
RBI Update on FAQs as on October 9, 2017 has modified Question 19 in the FAQs on Issuance of Rupee Denominated Bonds Overseas.

Q.19 What are the reporting requirements in respect of such bonds?

Ans. Bonds can be issued only after obtaining Loan Registration Number (LRN) from the Reserve Bank as applicable to ECBs. Borrowers are required to submit duly certified Form 83 in duplicate to the designated AD Category-I bank. In turn, the AD Category-I bank will forward one copy to the Director, Balance of Payments Statistics Division, Department of Statistics and Information Management (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051 for obtaining LRN. The reporting through ECB 2 Return will also be required. Additionally, the borrower is required to fulfil reporting requirements/ maintain details of issuance of such bonds as required by Government or by other regulators/ bodies/Acts.

Earlier update was on 9th June, 2017

Refer https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=113&fn=5



CA Zubin Billimoria

In Focus – Accounting and Auditing

Overview of Transition to and adoption of Ind-AS

Introduction

With the notification of the roadmap by the Ministry of Corporate Affairs for adoption of International Financial Reporting Standards (IFRS) converged Indian Accounting Standards (Ind-AS) by all listed companies and large unlisted companies already underway for the Phase I entities during the financial year ended 31st March, 2017 (those having a net worth of more than ₹ 500 crore as on 31st March, 2014 and at a subsequent date), the adoption of the same will lead to many changes in the financial statements of companies, both in terms of presentation and numbers. The adoption by Phase II entities is already underway for the remaining listed entities and other entities having a net worth of more than ₹ 250 crores during the current financial year ending 31st March, 2018. Also, the road map for adoption of Ind AS by banks and NBFCs would also commence from the financial year ending 31st March, 2019 and 2020 (for certain NBFCs). Finally, for Insurance Companies, the IRDA has recently deferred the implementation of Ind AS from the financial year ending 31st March, 2021.

The transition to and adoption of Ind-AS is not just a financial or accounting issue but an enterprise level transition impacting the entire business and various stakeholders involved therein. Whilst a detailed analysis of the same is beyond the scope of this article, just to get a broad level perspective, there are several areas other than accounting where there would be an impact, some of which are highlighted hereunder:

- Impact of transition on the profit/loss, financial position and net worth of the entity
- Communication with the Board and / or Audit Committee
- Increased volatility in the results
- Increased disclosure requirements, both quantitative and qualitative which would result in greater transparency There would be significantly detailed disclosures about management judgments and estimates

- Changes in existing information systems requirements, especially for Financial Service enterprises
- Impact on reporting on Internal Financial Controls
- Need for increased availability of and enhanced capability of resources.
- Greater alignment with business operations due to increased focus on substance rather than legal form. There would be greater emphasis on the underlying business rationale and true economics of various transaction
- Tax implications of and the cost associated with the transition
- Loan covenants
- Dividend distribution
- Investor relations

An attempt has been made in the foregoing paragraphs to briefly examine the various practical considerations in the transition to and adoption of Ind-AS by corporates.

Preparation of Ind-AS Opening Balance Sheet

The first and foremost consideration in the transition to Ind-AS is the preparation of the opening Balance sheet. Whilst preparing the Opening Ind-AS Balance Sheet, subject to the mandatory exceptions and exemptions, an entity would normally require to ascertain the adjustments under the following broad headings:

- **Not to recognise items as assets and liabilities if Ind-AS does not permit their recognition.**
- **Recognise all assets and liabilities whose recognition is required by Ind-AS.**
- **Reclassify assets, liabilities, and items of equity as per Ind-As requirements.**
- **Measure all assets and liabilities in accordance with Ind-AS**

Let us now examine some of the common adjustments which may be required under each of the above heads.

Not to recognise items as assets and liabilities if Ind-AS does not permit their recognition:
Some of the common adjustments which may be required in respect thereof are briefly discussed hereunder:

- **Ind-AS-10** *Events after the Reporting Period* does not permit recognition of **proposed dividends** as an adjusting event and hence the same is not to be presented as a liability as is the case with AS-4. The proposed dividend is only required to be disclosed as a note.
- Any **deferred income or expenditure** such as premium / discount on issue / redemption of debentures / bonds or expenses on issue of debentures or bonds recognised in terms of the special dispensation under AS-26, and which are an integral part of the amortised cost of financial assets and liabilities should be factored in to determine the effective interest rate and reversed in the opening balance sheet.
- The carried forward balance of any **share issue expenses** which are amortised in terms of the special dispensation under AS-26 are required to be eliminated whilst preparing the opening balance sheet.
- Any **contingent assets or reimbursements** like insurance or other claims which are not virtually certain and do not meet the recognition criteria under **Ind-AS 37** should be reversed in the opening balance sheet.

- In the opening consolidated financial statements, assets and liabilities of **joint ventures** which are included under the Proportionate Consolidated method should be reversed since the same is no longer permissible
- Any **held for sale** subsidiary, associate or joint venture should be eliminated from consolidation and disclosed as a separate disposal group.

Recognise all assets and liabilities whose recognition is required by Ind-AS

Some of the common adjustments which may be required in respect thereof are briefly discussed hereunder:

- All **derivative financial assets and liabilities** and **embedded derivatives** shall be recognised, if not done earlier.
- Certain provisions in the nature of restructuring obligations, onerous contracts, decommissioning liabilities, site restoration, warranties, litigation etc., need to be recognised based on **constructive obligations**, which may not have been recognised earlier or were disclosed as contingent liabilities.
- Various **intangible assets** like brands, customer lists etc. acquired in a **business combination**, which earlier were part of goodwill need to be recognised if retrospective application of **Ind-AS 103** is opted for.
- Recognition of certain new **investment properties** in view of the differences in the recognition criteria e.g. land held for long term capital appreciation, building that is vacant but is held to be leased under one or more operating leases etc.
- **Deferred tax assets and liabilities** would need to be recognised based on the **Balance Sheet approach.**
- In the consolidated financial statements investments in **joint ventures** need to be recognised based on the **equity method.**
- Assets and liabilities of any held for sale subsidiary, associate or joint venture would need to be recognised and presented as a **disposal group**.

Reclassify assets, liabilities, and items of equity as per Ind-AS requirements

Some of the common adjustments which may be required in respect thereof are briefly discussed hereunder:

- Classification of financial liabilities and equity should be based on the **substance** rather than legal form e.g., redeemable preference shares would need to be reclassified as debt, fully convertible debentures would need to be reclassified as equity etc.
- **Compound financial instruments** need to be **split** into debt and equity components e.g., partly / optionally convertible bonds.
- Financial assets, notably **investments**, need to be **reclassified** into amortised cost, fair value through profit and loss, fair value through other comprehensive income etc.
- Certain **intangible assets acquired as part of earlier business combinations** may not meet the definition of intangible assets and hence need to be included as part of **goodwill** e.g., certain acquisition cost, promotional cost etc.
- An entity preparing **consolidated financial statements** for the first time or which has not consolidated any subsidiary under AS-21 e.g., where the control is exercised through the power to govern the operating policies and business decisions rather than through shareholding alone would need to

incorporate the relevant assets and liabilities.

Measure all assets and liabilities in accordance with Ind-AS.

Some of the common adjustments which may be required in respect thereof are briefly discussed hereunder:

- In case of purchase of **inventories, fixed assets and intangible assets** on **deferred settlement terms,** the interest element would need to be segregated.
- In case **fixed assets** if the **fair value model** is opted for, it would necessitate a remeasurement
- **Government grants** in the form of non-monetary assets or **concessional loans** are to be measured **at the fair value.**
- **Borrowing cost** are to be calculated using the **effective interest rate** method.
- Where the time value of money is material, **provisions** should be on a **discounted** basis.
- **Share based payment transactions** need to be recognised on a **fair value** basis.
- Assets and liabilities acquired in a **business combination** need to be measured at **fair value.**
- **Non-current assets held for sale and Discontinued Operations** need to be measured at fair value less costs to sell.
- All Financial assets and liabilities to be initially recognised at fair value and subsequently measured based on their classification as discussed seaprately.

As part of the transition to Ind-AS entities are also required to evaluate the various exemptions, both mandatory and voluntary, which are provided for under Ind-AS-101, the important ones of which are briefly discussed hereunder:

Mandatory exemptions to retrospective application of Ind-AS

A first time adopter is provided with the following key mandatory exemptions to retrospective application of certain Ind-AS:

Derecognition of Financial Assets and Liabilities

There is no need to recognise any financial asset or liability which is already derocognised under local GAAP. Alternatively, the entity may apply derecognition criteria retrospectively by choosing a cut off date.

Hedge Accounting

Any transactions entered into before the date of transition are not to be retrospectively designated as hedges.

Classification and Measurement of Financial Assets and Liabilities

- The determination of cash flows for time value measurement of financial assets on the date of transition is not required when it is impracticable to assess the same retrospectively, subject to adequate disclosures being made till their derecognition.
- For measurement of existing financial assets and liabilities on the date of transition, if it is impracticable to determine effective interest rate retrospectively, the fair value on the date of transition shall be the new gross carrying amount or the new amortised cost for applying the effective interest method.

Embedded Derivatives

A first time adopter shall assess whether an embedded derivative is required to be separated from the host contract on the basis of conditions that existed at the later of the date it first became a party to the contract and the date of reassessment.

Government Loans

The benefit of a Government loan at below market rate of interest is not required to be recognised as a Government grant on the date of transition.

Voluntary exemptions to retrospective application of Ind-AS

A first time adopter is provided with the following key voluntary exemptions to retrospective application of certain Ind-AS. *Understanding the same is of critical importance since it could impact comparability of results of entities in the same sector.*

Share based Payment Transactions

Voluntary retrospective application of fair valuation in respect of equity instruments granted, vested and not settled or any modification made before the date of transition is available. Similar considerations apply to any liabilities arising out of such transactions which are settled before the date of transition. However, an entity may adopt earlier application if fair value disclosures have been publicly made.

Deemed Cost of Property, Plant and Equipment and Intangible Assets

The entity can opt for the previous GAAP carrying amount as deemed cost. Alternatively, the fair value for individual items on the date of transition can also be considered as the deemed cost provided it is comparable with what is required under Ind-AS. In certain cases, an event driven fair value used during a privatisation, IPO etc., can also be considered as a deemed cost. In case fair value is taken as deemed cost, the same should be allocated component wise and depreciation shall be calculated accordingly.

Deemed Cost of Investment Property

These may be identified on the date of transition based on Ind-AS criteria of these being used to earn rentals or for capital appreciation as against the AS-13 criteria of it not being intended to be used or occupied substantially in the operations of the enterprise.

Leases

- Separate classification where lease includes both land and building into the finance (normally for land) and operating lease, as applicable on the date of transition is permissible where there is a composite lease of land and building.

- Determining whether an arrangement contains a lease on the date of transition based on the specific assets test-fulfilment of the arrangement is dependent on the use of a specific asset or right to use of an asset.

Cumulative Translation Differences

- Cumulative translation differences for all foreign operations (Ind-AS does not distinguish between integral and non-integral operations) on the date of translation shall be zero; and

- Gains and losses on subsequent disposal of foreign operations shall exclude translation differences prior to the date of transition.

Long Term Foreign Currency Monetary Items

- If these are reflected under FCMDTA account, similar treatment can continue on the date of transition.

- In case these are adjusted against the carrying value of the fixed assets, similar treatment can continue only if the entity adopts the deemed cost model as discussed above.

Investments in subsidiaries, associates and joint ventures
Deemed cost as per previous GAAP (i.e., fair value in the separate financial statements on date of transition or previous GAAP carrying amount) on the date of transition can be used.

Assets and Liabilities of subsidiaries, associates and joint ventures
If an entity adopts Ind-AS before or simultaneously with the parent / investor, no adjustments required. However, if the entity adopts Ind-AS later than the parent / investor, respective carrying amounts on the date of the investors / parent's transition can be considered.

Compound Financial Instruments
An entity is required to split into liability and equity components retrospectively unless liability component is no longer outstanding on date of transition.

Designation of previously recognised Financial Instruments
All financial assets are required to be classified into three types, as under:

- ***Fair value through Profit and Loss*** *in cases where the holding of the financial asset helps to eliminate or significantly reduce measurement or recognition uncertainty or holding period is less than 12 months. It can be used irrespective of the business model discussed below.*
- ***Fair value through other comprehensive income*** *in cases where the business model involves collection of contractual cash flows either through selling the asset or through principal and interest payments.*
- ***Amortised cost*** *in cases where the business model involves collection of contractual cash flows of interest and principal.*

All financial liabilities are required to be classified into two types, as under:

1. *Fair value through* Profit and Loss (very selectively)
2. Amortised cost.

The above designations can be either at initial recognition or on the date of transition.

The amortised cost of financial assets and liabilities shall be determined on the basis of the benchmark interest rate on the date of transition, if it is impractical to determine the same retrospectively.

All equity instruments always to be classified at fair value – either through Profit & Loss or through Other Comprehensive Income and no recycling permissible if option of classifying through OCI is selected – No specific impairment analysis required

Fair Value measurement of Financial Assets and Liabilities on Initial Recognition

This may be applied prospectively to transactions entered into on or after the date of transition.

Decommissioning Liabilities included in Cost of fixed assets
Where exemption from retrospective application is sought, following needs to be done:

- Measure the liability on the date of transition as per Ind-AS 37.
- To the extent it is to be included in the cost of the asset, the amount should be estimated based on the assumption that it would be included when the liability first arose and then discounted accordingly, using historical risk adjusted discount rates (based on average annual inflation, and incremental borrowing rates).
- Calculate accumulated depreciation on the above amount using current estimated useful life.

Service Concession Arrangements

- Recognise financial assets and intangible assets on the date of transition.
- Use the previous GAAP carrying amounts.
- Test for impairment at the date of transition unless impractical to do so.

Business Combinations

- An entity may choose not to apply Ind-AS-3 to business combinations that occurred before the date of transition.
- However, if it decides to restate any past business combinations, it should restate all business combinations after that date.

Apart from the various exemptions, certain other key considerations under various Ind-ASs are discussed hereunder:

Other key considerations in transition

Ind-AS-2 Inventories

- In respect of inventories acquired on deferred settlement basis, the interest element thereon shall be excluded. This needs to be adjusted on the date of transition.
- Sale of inventories after the reporting period would be an adjusting event under Ind-AS 10 discussed below which would need to be adjusted on the date of transition.

Ind-AS10 Events After Reporting Period

- Any provision for proposed dividend and related dividend distribution tax after the reporting period shall be reversed and added back to retained earnings.
- Settlement of a court case after reporting period confirms the existence of a present obligation and accordingly the previously created provision needs to be adjusted or fresh provision need to be created in terms of Ind-AS-37.
- An entity shall adjust cost of assets purchased based on information available after reporting period if it opts for carrying value as the deemed cost.
- On the date of transition any legal and / or constructive obligations after the reporting period shall be taken into account if not considered under previous GAAP. **(see discussion on Ind-AS 19 on Employee Benefits below)**

Ind-AS 19 on Employee Benefits

- Actuarial gains and losses arising on defined benefit plans and other long term employee benefits should be recognised in the Statement of Other Comprehensive Income and cannot be recycled to the Profit and Loss Account.
- All past service costs need to be immediately expensed off.
- Instead of recognising interest cost in the Profit and Loss Account, Ind-AS-19 requires recognition of net interest cost based on the net defined benefit asset or liability and the discount rate at the beginning of the year.
- Other miscellaneous adjustments in the actuarial assumptions.
- **Revised actuarial valuation would be required.**
- More specific guidance on accounting for constructive obligations i.e. as a result of informal practices. These would need to be henceforth recognised in the financial statements

Ind-AS 23 on Borrowing Costs

- Inventories which are manufactured or otherwise produced in large quantities on a repetitive basis are not considered as qualifying assets even if they take a substantial period of time to get ready for their intended use or sale. e.g wines, cheese etc.

- Borrowing costs shall be measured applying **effective interest rate method** from the date transition date. Accordingly, ancillary borrowing cost written off earlier need to be amortised. Earlier period borrowing costs should not be restated.

- Dividend payable in respect of compulsorily redeemable preference shares would also need to be considered as borrowing costs eligible for capitalisation depending on the specific circumstances.

Ind-AS 12 Income Taxes

- Balance Sheet method to be adopted for computation of deferred tax asset or liability by which the tax base is compared with accounting base. Primary impact would be in respect of business combinations and consolidation adjustments.

- *Tax base of an asset is the amount deductible for tax purposes against any taxable economic benefits that would flow to the entity when it recovers the carrying amount of the asset. e.g depreciable assets, uncollected income taxed on a cash basis, assets measured at fair value where the fair value gain is not taxed or fair value loss is disallowed.*

- *Tax base of a liability is its carrying amount, less any amount deductible for tax purposes. E.g. income received in advance taxed at a later date, loan payable having an amortised cost.*

- *A first time adopter would have to establish the history of items that give rise to temporary differences and adopt retrospective application.*

Ind-AS 38 Intangible Assets

- Unamortised share issue expenses need to be charged off. Amounts in the nature of transaction cost need to be reduced from equity.

- Any unamortised borrowing costs need to be analysed. Initial transaction cost need to be reduced from the borrowings and any ancillary cost needs to be considered in the calculating the effective interest rate.

- Revenue based amortisation of toll roads would not be permitted for toll roads arising after the transition date.

- Amortisation of intangible assets with indefinite useful life not permitted. E.g. Right of Way, Stock Exchange broking card etc. These would however need to be tested for impairment.

Ind-AS 21 Effects of Changes in Foreign Exchange Rates

The concept of functional currency introduced for the first time. No first time exemption provided. *It is the currency of the **primary economic environment** in which the entity operates. It is normally the currency which influences the income and expenses the most. e. g. shipping company.*

Ind-AS 37 Provisions, Contingent Liabilities and Contingent Assets

- Specific requirement to recognise provision sin respect of constructive obligations. AS-29 does not specifically refer to the same. *It only refers to creation of provisions arising out of normal business customs and practices, to maintain business relations etc.*

- Restructuring provisions need to be made based on constructive obligations as against legal obligations in terms of AS-29.

- **Discounting of provisions where effect of time value of money is material.**

Other areas having significant impact

Financial Instruments

Recognition and Measurement

- Greater use of **fair value** – use of judgment and valuation tools in many cases.

- **Impairment** to be calculated on the *Expected Credit Loss Model.*

  - Assessment of whether there is a significant increase in the credit risk since initial inception or there is a low credit risk; in which case 12 months expected credit losses are recognised.

  - Where significant increase in credit risk since initial inception and no objective evidence of impairment, in which case life time expected credit losses to be recognised on a PD basis

  - Where there is objective evidence of impairment, life time expected credit losses are recognised and interest income is computed on the net basis (i.e. net of credit allowances)

  - **The above will have a big impact on financial institutions and NBFCs which are covered at a later date. However, in the interim any loans granted by non-financial entities would still need to be evaluated since currently they are not even covered by the prudential guidelines. Financing of group entities would need closer scrutiny.**

- **Derivative Instruments** – Currently there are diverse practices adopted. Whilst some entities were adopting AS-30 (which is recommendatory in nature), other entities are following the ICAI announcement which requires only losses to be recognised. Post adoption of Ind-AS, consistency would creep in and recognition of both gains and losses either through Profit and Loss or OCI (where hedge accounting is adopted) would be required. The impact would be **greater for entities who were *hitherto following the ICAI announcement and recognising only losses.***

- **Transaction costs**
  - In respect of **long-term borrowings** will be recognised over the tenor of the borrowing using the effective interest rate method as against the current practice of charging off.

  - In respect of **financial assets** these would need to be charged off as against the current practice of capitalising the same, unless these are in respect of financial assets recorded on amortised cost basis, in which case they would need to be adjusted against the carrying value.

Business Combinations

Recognition and measurement

- **Acquisition value**
  - Assets and liabilities to be recognised at fair value.
  - Contingent Liabilities and Intangible Assets not recognised in the acquiree's financial statements would also need to be recognised at fair value.

- Non-controlling interests to be measured at fair value.
- Significant changes in the value of goodwill reflecting a more accurate depiction of the premium paid on acquisition even though the legal form of the acquisition has not changed.
- Recording of assets at fair value will normally result in higher depreciation and amortisation – In case of intangibles with indefinite useful life or with higher useful life lower or no amortisation.
- Goodwill will not have to be amortised but tested for impairment.
- In case of a business combination in stages, the previously held equity interest to be measured at acquisition date fair value, with resultant gain or loss recognised in the Profit and Loss resulting in greater volatility in the Income Statement.

• **Accounting for Transaction Costs**
  - These need to be charged off as against the current practice of generally capitalising them.

• **Accounting vis-à-vis High Court Orders**
  - Under the Companies Act, 2013 certificate from the auditors required whether scheme is in accordance with the Accounting Standards thereby doing away with the leeway provided under the Companies Act, 1956.
  - Concept of appointed and effective date is no longer relevant. What is now relevant is the date from which the control is effected. However, issues could arise in the intervening period in respect of pending cases.
  - With the notification of the relevant provisions under the Companies Act, 2013, the NCLT would now play the role of the High Court under the erstwhile Companies Act, 1956.

Consolidated / Group Accounts

Recognition and Measurement

• **Preparation of Consolidated Financial statements**
  - Many additional SPEs would get consolidated and there could be deconsolidation of certain subsidiaries since two companies cannot consolidate the same subsidiary since control can be exercised only by one entity. Investment entities are also not required to be consolidated.
  - Consolidation mandated under the Companies Act, 2013 of associates and joint ventures even if there are no subsidiaries.
  - Proportionate consolidation method no longer permissible.
  - **Definition of control is different. An investor is deemed to control an enterprise only when he has the power over the entity or when he has exposure or rights to variable returns from its involvement with the investee and has the ability / power the affect these returns. Such powers can be exercised even when there is no majority ownership. Even potential voting rights are relevant.**
  - Changes in ownership interest that do not result in loss of control

should be adjusted against equity. No guidance under current GAAP and hence differing practices were adopted.

  - Losses incurred by the subsidiary to be allocated between the controlling and non-controlling interest as against the practice under Indian GAAP of adjusting these against the majority, unless there is a binding obligation to make good the losses.

- **Uniform Accounting Policies**
  - Not very rigid and strictly enforceable under current GAAP.
  - Challenges could be encountered especially in case of associates over which control is not exercised.
  - **Many group entities would be required to change their policies, the individual impact of which would need to be evaluated.**

- **Uniform Financial Year**
  - Maximum gap reduced to three months as against six months.
  - On adoption many entities would be compelled to change their year ends.

Income Taxes

Recognition and measurement

- Recognition based on Balance Sheet method for taxable temporary differences as against timing differences under the current GAAP.
- Recognition of deferred tax on business combinations.
- Recognition of deferred tax assets on losses is not very stringent.
- Deferred tax liability required to be recognised in consolidated financial statements for all taxable temporary differences in connection with group investments unless the investor is able to control the timing of the reversal in the foreseeable future.
- Significantly detailed disclosures and reconciliations.

Employee benefits and share based payments

Recognition and measurement

- Actuarial gains and losses to be taken to Other Comprehensive Income which will reduce volatility.
- Employee benefits are required to be recognised based on constructive obligation as against the current practice of generally recognising the same based on legal obligation.
- ESOPS to be mandatorily recorded on a fair value basis which would result in increased charges and hence have a significant impact on key performance indicators like EPS.
- Share based payments to non-employees like vendors against supply of goods and services would need to be recorded on a fair value basis in all cases, which is currently missing. Only fixed assets so acquired are accounted for at fair value in terms of AS-10. This could have a negative impact on the financial results and other performance indices, dividend servicing abilities and loans covenants, amongst others.

Property, plant and equipment

Recognition and measurement

- **Mandatory component accounting**
  - Any cost which is significant in relation to the total cost and has a

separately defined useful life need to be separately identified and depreciated accordingly.

– Residual value calculations and estimates need to be evaluated afresh.

– **Even companies not adopting Ind-AS need to adopt the same in terms of the Companies Act, 2013.**

– Expected to a have a material and significant impact on highly capitalised manufacturing entities and IT technology companies.

– Could have a significant impact on insurance, asset backed financing, amongst other matters.

- **Revaluation of Assets**
  – *No selective revaluation permitted.*
  – *Updation of revaluation on a regular basis.*
  – *Depreciation charge to be charged off to Income Statement.* ***Even companies not adopting Ind-AS need to follow the same in terms of the Companies Act, 2013***
  – *Since it is an option it can affect comparability of results of the same class of companies and hence uniformity in terms of loan covenants including security cover etc. would be an issue.*
  – *For companies adopting the revaluation route whilst the asset base would be higher, there would also be a higher corresponding depreciation charge*

- **Repairs and overhaul expenditure**
  – *Needs to be capitalised if it satisfies the recognition criteria.*
  – *Corresponding decapitalisation of the replaced parts.*
  – *Closer scrutiny of the renewal and asset maintenance policies of companies, especially those which are asset heavy.*

- **Unrealised Exchange Differences**
  – *These are required to be charged off in all cases prospectively.*
  – *Companies who have opted for the transitional relief for continuing treatment of capitalisation in terms of* ***para 46A of AS-11*** *till the tenor of the loans or till FY 2020. This would impact comparability of results.*
  – *Greater volatility in the results of companies who have large overseas borrowings.*

Intangible Assets

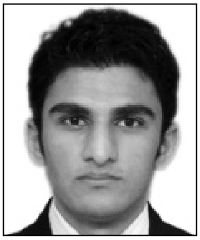
Recognition and measurement

- Intangible assets can have indefinite useful lives, identification of which should be adequately and appropriately demonstrated and justified. Such assets need to be subjected to an annual impairment assessment.

- Fair valuation is now permissible especially if an active market exists.

Conclusion

The above assessment is just the tip of the ice-berg and in actual practice there could be many other issues, challenges and implications which would merit a detailed assessment.



Rahul Sarda, *Advocate*

BEST OF THE REST

1. Practising Chartered Accountant – Enrolment as Advocate – Not permitted

The petitioner, a Chartered Accountant and member of ICAI, held certificate of practice issued by the ICAI. He was engaged in the practice as Chartered Accountant, however, the petitioner also having LL B degree, applied for permission for membership of the Bar Council of Gujarat. He contended that the practice as a Chartered Accountant is nothing but a law practice relating to commercial branch i.e. Income-tax Act, Companies Act, Partnership Act etc. or Debt Recovery Tribunal.

Held, the enrollment as a member of the profession is subject to the law made by the Parliament i.e. the Advocates Act. Section 28 of the Advocates Act empowers the Bar Council which is an apex body to make the rule for the member of the profession i.e. the Advocates including the Rules for enrollment. The submissions of the Petitioner that there is nothing which prohibits and, therefore, he should be allowed to ride on two horses in two profession, cannot be accepted. Any person, as a member of profession, has to discharge his obligation and, therefore, the profession as an Advocate or Lawyer which is a full time profession, a person cannot be permitted if he is already working as a professional like that of Chartered Accountant. Therefore, it was held that a practising Chartered Accountant could not be enrolled as Member of State Bar Council for practice of law as an advocate under State Bar Council Rules.

Mam Raj Goel vs. Bar Council of Gujarat [2017] 85 taxmann.com 77 (Guj.)

2. Insolvency & Bankruptcy Code – Power of NCLT to allow withdrawal of application filed under the Insolvency and Bankruptcy Code

The Operational Creditor, Parker Hannifin India (P) Ltd., preferred an application under the Insolvency & Bankruptcy Code, 2016 against the corporate debtor, Prowess International (P) Ltd. The Adjudicating Authority i.e. the NCLT, by order dated 20th April, 2017, admitted the application and initiated the 'Corporate Insolvency Resolution Process'. The Corporate Debtor having come to know of order passed by the NCLT settled the dispute with the Operational Creditor and other Creditors and filed an Interlocutory Application for withdrawal of the petition contending *inter alia* that the application had been admitted on 20th April 2017, without notice to the Corporate Debtor. However, the application was rejected.

Held, as per Rule 8 of I&B Code (Application to Adjudicating Authority) Rules, 2016, the NCLT may permit withdrawal of the application on the request of the applicant before its admission. Tribunal had no power to allow any applicant or any other person to withdraw the application after admission. However, the NCLAT noticed that the order of the NCLT had been passed in violation of rules of natural justice without notice to the Corporate Debtor. If the order dated 20th April, 2017 would have been challenged by the appellant, it was open for the NCLAT to set aside the order and then to permit the Operational Creditor to withdraw the application, in view of settlement. Since in the instant case, as the order of admission was not under challenge and the application could not be withdrawn after admission, held the relief as sought for by the appellant could not be granted.

In the circumstances, instead of interfering with the impugned order, the case was remitted to the NCLT for its satisfaction whether the interest of all stakeholders have been satisfied after giving notice to individual claimant and taking into consideration the Insolvency Resolution plan and report of the Insolvency Resolution Professional, as may be prepared.

Prowess International (P) Ltd. vs. Parker Hannifin India (P) Ltd. [2017] 85 taxmann.com 187 (NCLAT – New Delhi)

3. Arbitration and SARFAESI proceedings can go simultaneously for recovery of debts due

The appellants borrowed monies for their business against security of immovable properties by the creation of an equitable mortgage by deposit of title documents from the Respondent – NBFC. The agreement *inter se* the parties contained an arbitration clause and thus, the matter went to arbitration on the lender/respondent invoking the arbitration clause. The Respondent – NBFC issued a notice under Section 13(2) of the SARFAESI Act for one of the seven properties mortgaged in its favour by the Appellant – borrower. The question was whether arbitration proceedings initiated by the respondent can be carried on along with the SARFAESI proceedings simultaneously.

Held, it is trite to say that arbitration was an alternative to the civil proceedings. The appellants could hardly be permitted to contend that the initiation of arbitration proceedings would, in any manner, prejudice their rights to seek relief under the SARFAESI Act. The provisions of the SARFAESI Act were a remedy in addition to the provisions of the Arbitration and Conciliation Act. SARFAESI proceedings are in the nature of enforcement proceedings, while arbitration is an adjudicatory process. In the event that the secured assets are insufficient to satisfy the debts, the secured creditor can proceed against other assets in execution against the debtor, after determination of the pending outstanding amount by a competent forum.

Therefore, it was held that SARFAESI proceedings and arbitration proceedings could go hand in hand.

M. D. Frozen Foods Exports (P) Ltd. vs. Hero Fincorp Ltd. [2017] 86 taxmann.com 92 (SC)

We are ever free if we would only believe it, only have faith enough.

— *Swami Vivekananda*

CA Ketan Vajani & CA Nishtha Pandya
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 8th October, 2017 to 7th November, 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 10th November, 2017.

LIFE MEMBERSHIP

1	Mr. Chhajed Piyush Sohanraj	CA	Mumbai
2	Mr. Peddi Pranav Ramesh	CA	Karim Nagar
3	Mr. Bathiya Janak Shailesh	Advocate	Mumbai
4	Mr. Khandhar Amish Jaswantlal	CA	Ahmedabad
5	Mr. Vaja Rashmin Shasikant	CA	Ahmedabad

ORDINARY MEMBERSHIP

1	Mr. Savla Nainit Digesh	CA	Mumbai
2	Ms. Dipti Narayanswami Shankaran	Advocate	Mumbai
3	Mr. R. Srinivasan Ratnaswami	Advocate	Madurai
4	Mr. Chheda Niraj Bharat	CA	Mumbai
5	Mr. Sawant Amit Anil	CA	Mumbai
6	Ms. Jain Jini Kiran	CA	Mumbai
7	Mr. Dalal Ketan Arvind	CA	Mumbai
8	Mr. Buch Vidyut Vishwakant	B.Com	Gandhidham
9	Mr. Lodhapukraj Sujanmal	CA	Mumbai
10	Mr. Lohiya Dilip Purushottam	CA	Nagpur
11	Mr. Bali Baldev Krishan	Advocate	Mumbai

STUDENT MEMBERSHIP

1	Ms. Shah Palak Dharmendra	Student	Mumbai
2	Ms. Jain Meenal Devendrakumar	Student	Mumbai

ASSOCIATE MEMBERSHIP

1	PKAA & Associate	New Delhi

II. Past Programmes

1. INDIRECT TAXES COMMITTEE

GST Study and Refresher Course held on 1st November to 4th November, 2017 held at RVG Educational Foundation, 57, Lallubhai Shamaldas Road, Andheri (West) Mumbai. The Course was addressed by CA Divyesh Lapsiwala, CA Naresh Sheth, CA Vinod Atwani, CA Rajiv Luthia CA Manish Gadia and Mr. Shailesh Sheth, Advocate. The panellists were Mr. V. Sridharan, Sr. Advocate, Dr. Waman Parkhi and Mr. Rohit Jain, Advocate. CA Naresh Sheth being the moderator.

III. Future Programmes

1. ACCOUNTING & AUDITING / ALLIED LAWS AND DIRECT TAX COMMITTEE

3 Days Conference on Real Estate Laws – Combating Challenges Arising out of Various Laws is scheduled to be held on 11th, 18th and 25th November, 2017 at IMC.

2. INDIRECT TAX COMMITTEE

6th Residential Referencer Course on GST is scheduled to be held from 25th to 28th January, 2018 at The Ananta, Udaipur.

3. RESIDENTIAL REFRESHER COURSE & SKILL DEVELOPMENT COMMITTEE

41st Residential Refresher Course is scheduled to be held from 22nd to 25th February, 2018 at Taj Swarna, Amritsar.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of September, 2017)

Indirect Taxes Committee

GST Study and Refresher Course held on 1st to 4th November, 2017 at RVG Educational Foundation, Andheri (W), Mumbai – 400 058

DAY 1

Inaugural Session. Seen from L to R: CA Sumit Jhunjhunwala (Convenor), CA Naresh Sheth (Chairman), Mr. Ajay R. Singh, Advocate (President), CA Divyesh Lapsiwala (Speaker), CA Bharat Oza (Convenor) and CA Hemang Shah (Convenor)

Dignitaries on dais Seen from L to R: CA Naresh Sheth (Chairman), CA Divyesh Lapsiwala (Speaker), Mr. Ajay R. Singh, Advocate (President), CA Bharat Oza (Convenor) and CA Hemang Shah (Convenor)

Faculties

CA Divyesh Lapsiwala addressing the participants

CA Naresh Sheth addressing the participants

DAY 2

Dignitaries on dais. Seen from L to R: CA Naresh Sheth (Chairman), CA Vinod Awtani (Speaker), CA Nishtha Pandya (Hon. Jt. Secretary) and CA Hemang Shah (Convenor)

CA Vinod Awtani addressing the participants

Dignitaries on dais. Seen from L to R: CA Atul Mehta (Vice-Chairman), CA Rajiv Luthia (Speaker), CA Naresh Sheth (Chairman) and CA Hemang Shah (Convenor)

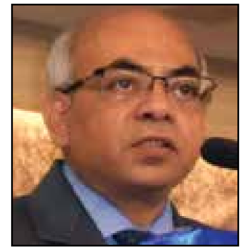
CA Rajiv Luthia addressing the participants

Indirect Taxes Committee

GST Study and Refresher Course held on 1st to 4th November, 2017
at RVG Educational Foundation, Andheri (W), Mumbai – 400 058

DAY 3

CA Naresh Sheth (Chairman) welcoming the speakers. Seen from L to R: Mr. Shailesh Sheth, Advocate (Speaker), CA Ketan Vajani (Hon. Jt. Secretary) and CA Hemang Shah (Convenor)



Mr. Shailesh Sheth, Advocate addressing the participants

CA Atul Mehta (Vice-Chairman) welcoming the speaker. Seen from L to R: CA Manish Gadia (Speaker), CA Parag Ved (Hon. Treasurer) and CA Sumit Jhunjhunwala (Convenor)

CA Manish Gadia addressing the participants

DAY 4

Panel Discussion. Seen from L to R: CA Hinesh Doshi (Vice-President), Mr. V. Sridharan – Senior Advocate, CA Naresh Sheth (Chairman), Mr. Ajay R. Singh - Advocate (President), Mr. Rohit Jain – Advocate, CA Parind Mehta and CA Sumit Jhunjhunwala (Convenor)

Mr. Ajay R. Singh, Advocate (President) presenting memento to panellist Mr. V. Sridharan, Senior Advocate

CA Hinesh Doshi (Vice-President) presenting memento to panellist Mr. Rohit Jain, Advocate

CA Rajiv Luthia (Speaker) presenting memento to panellist CA Parind Mehta

International Taxation Committee

FEMA Study Circle on Changes in FDI Policy held on 9th October, 2017 at CTC Conference Room

CA Rajesh L. Shah
addressing the participants

Accounting & Auditing Committee

Intensive Study Group on Ind-AS 37 – Provisions, Contingent Liabilities and Contingent Assets held on 10th October, 2017 at SNDT Committee Room

CA Zubin Bilimoria
addressing the participants

Study Circle & Study Group Committee

Study Circle on Disclosures of ICDS in Tax Audit Report held on 14th October, 2017 at Kilachand Hall, IMC

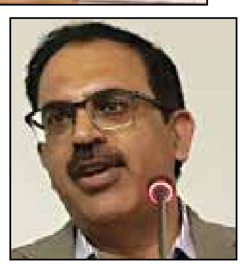
CA Mahendra Sanghvi
addressing the participants

Delhi Chapter

Full day workshop on The Insolvency and Bankruptcy Code, 2016 (IBC) – Emerging Issues, Challenges and Professional Opportunities held on 10th October, 2017 at India International Centre, Lecture Room I, New Delhi – 110 003

Dignitaries on dais. Seen from L to R: Mr. R. P. Garg (Imm. Past Chairman), Mr. Vinod Wahi (Speaker), Mr. V. P. Verma (Advisor) and Mr. Madhusudhan Sharma (Speaker)

Mr. Vinod Wahi
addressing the participants



Mr. Ashish Makhija
addressing the participants

Membership and Public Relations Committee jointly with The Jamnagar Chamber of Commerce and Industry, Jamnagar, Jamnagar Branch of WIRC of ICAI, Jamnagar Income Tax Practitioners Association and The Commercial Tax Practitioner Association, Jamnagar

Full day Seminar on GST & RERA, held on 13th October, 2017
at The Jamnagar Chamber of Commerce and Industry Dhirubhai Ambani Vanijya Bhavan
Near Subhash Bridge, Jamnagar-Rajkot Highway, Jamnagar, Gujarat 361 001

CA Sachin Gandhi (Co-Chairman, MPR Committee - CTC) addressing the gathering. Seen from L to R: CA Sanjeev Budh – Secretary ITPA, Mr. Axshat Vyas, Advocate – President CTPA, CA Umesh Rawani – President ITPA, CA Dipak Rindani - Speaker, Tulsibhai Gjera – President, The Chamber of Commerce, Jamnagar, CA Kamlesh Rathod – Vice President and Bipendrasinh Jadeja – Secretary

Dignitaries on dais. Seen from L to R: CA Bhavik Dholakiya - Past Chairmen Jamnagar ICAI Branch, CA Amit Mehta – Vice Chairmen, Vikram Mehta (Speaker), CA Sumit Jhunjhunwala (Speaker), Mr. Prakash Jhaveri – Advocate, CTPA and Mr. Rakesh Bhatt, Advocate, CTPA.

CA Vikram Mehta addressing the participants

CA Sumit Jhunjhunwala addressing the participants

Press Release at Jamnagar event.

Direct Taxes Committee

Intensive Study Group on Recent Important Decisions under Direct Taxes held on 7th November, 2017 at CTC Conference Room

CA Abhitan Mehta addressing the participants

Press Releases

WRIT Petitions filed by Chamber challenging the provisions of ICDS before Delhi High Court

High Court annuls 6 ICDS provisions, upholds its overall validity

Posted on November 10, 2017 by theasiatimes

The Delhi High Court has struck down six of the 10 provision under the Income Computation and Disclosure Standards (ICDS) as they override past judicial precedents. (Photo: Reuters)

The Delhi High Court has struck down six of the 10 provision under the Income Computation and Disclosure Standards (ICDS) as they overrode past judicial precedents. It, however, upheld the overall premise of this accounting principle for computing taxable income. The introduction of ICDS had helped India improve nearly 50 places on 'ease of paying taxes' parameter in the World Bank's 'ease of doing business' ranking released earlier this month. The Central Board of Direct Taxes (CBDT) introduced ICDS in 2016 as an alternate accounting method for the specific purpose of arriving at taxable income for those who are required to get their accounts audited as per the Income Tax Act, as distinct from the established practice of mercantile or cash accounting followed by corporates.

The CBDT had cited efforts by taxpayers to hide real taxable income under mercantile or cash accounting as the reason for introducing ICDS.

The overall impact of the 10 standards under ICDS was that it in most cases, the accrual of income is being accelerated while expenses are being delayed. "Most of the standards were issued to effectively overcome age-old accounting principles and norms that were being followed," Abhishek Goenka, leader corporate and international tax, PwC India said. The Chamber of Tax Consultants, a body made of tax professional, had petitioned the Delhi HC challenging the constitutionality of ICDS. The court said ICDS amounted to enacting new accounting laws, which was the sole function of Parliament and couldn't be exercised by the central government.

For instance, the court struck down the first ICDS provision related to 'prudence'. According to this principle, a company may compute its profit based on the expectation that revenue from sales made earlier may not accrue to it. The petitioners contended that this concept had been completely done away with by the respondents, which was present in the earlier accounting standards. The court agreed with the argument and struck down the provision.

Similarly, the court annulled the second provision of ICDS related to valuation of inventories which eliminated the distinction between a continuing partnership business after dissolution from one which is discontinued upon dissolution. The court held that it was contrary to the decision of the Supreme Court earlier. "It (ICDS-II) fails to acknowledge that the valuation of inventory at market value upon settlement of accounts of the outgoing partner is distinct from valuation of the inventory in the books of the business which is continuing, the court said of the provision and held it to be ultra vires the Act. The court also invalidated fourth ICDS provision saying: "ICDS-IV requires an assessee to recognise income from export incentive in the year of making the claim if there is 'reasonable certainty' of its ultimate collection. This is contrary to the decision of the Supreme Court in Excel Industries, and is, therefore, ultra vires the Act and struck down as such."

"This ruling upholds the overall validity of ICDS. Yet, and significantly, it strikes down several key standards on the grounds that the standards are contrary to rulings of the Supreme Court and that executive action cannot overturn these rulings. It is only an amendment in law that can make these changes," Goenka said.

The ruling came a day after the due date for corporate tax filings. For those covered by transfer pricing, the returns are due on November 30, and to that extent, it will also be important to analyse the impact on pending tax returns.

20 ECONOMY & PUBLIC AFFAIRS

HC upholds ICDS validity but strikes down key provisions

ASHLEY COUTINHO & INDIVJAL DHASMANA
Mumbai & New Delhi, 8 November

The Delhi High Court has upheld the constitutional validity of the Income Computation and Disclosure Standards (ICDS), but only to the extent that they do not go against judicial pronouncements and the provisions of the Income-Tax (I-T) Act.

These standards played a key role in improving India's position in the World Bank's ease of doing business rankings, released recently.

"The ICDS is not meant to overrule the provisions of the (Income Tax) Act, the rules thereunder, and the judicial precedents applicable thereto as they stand," said the court on Wednesday, striking down the ICDS provisions that went against judicial pronouncements and the I-T Act.

Hearing the petitions filed by the Chamber of Tax Consultants and others, the court also said wherever the ICDS amends the judicial pronouncements and I-T provisions, it should be brought by the legislature and not the executive.

For instance, the court struck down ICDS I, which does away with the concept of prudence, a key accounting principle to ensure assets and income are not overstated and liabilities and expenses not understated. According to this principle, a company might provide for bad and doubtful debts based on prudence, due to a doubt regarding non-realisation of sales booked in earlier years. This is not allowed, as deduced by the ICDS.

ICDS EXPLAINED
- Helped India improve on World Bank's ease of doing business ranking
- Court strikes down provisions that go against judicial pronouncements in the I-T Act
- Changes to judicial pronouncements and I-T provisions should come via the legislature and not the executive
- ICDS comes into effect from the current assessment year – 2017-18
- ICDS advances some revenues and postpones some expenditure for taxation

The court said, "ICDS I, which does away with the concept of 'prudence', is contrary to the (IT) Act and binding judicial precedents and is, therefore, unsustainable in law."

Under ICDS I, expected and mark-to-market losses are not allowed as a deduction, even though standard accounting principles generally allow it.

The court also held ICDS II ultra vires. This standard pertains to the valuation of inventories and eliminates the distinction between a continuing partnership business and the one after a partner quits. This is contrary to the decision of the Supreme Court in Shakti Trading Co. case, said the court. "ICDS II is held to be ultra vires the Act and struck down as such," it said.

Ajay Singh, president of the Chamber, said the court was fair enough to restrict the powers of the Centre to notify the ICDS so far as those were contrary to judicial pronouncements and the provisions of the I-T Act.

When asked whether the Chamber, a not-for-profit organisation with its mandate to disseminate knowledge in the field of taxation and other fields, would appeal against the court upholding the constitutional validity of the standards, he said it was still studying the finer points of the judgment.

The court also ordered against a provision in ICDS IV which requires an assessee to recognise income from export incentive in the year of making of the claim if there is "reasonable certainty" of its ultimate collection.

"The I-T Act provides enabling provisions to simplify computation of taxable income, thereby making the ICDS a delegated legislation. Hence, the ICDS cannot provide for taxation which is not within the ambit of the provisions of the I-T Act or accounting principles," said Pranay Bhatia, partner, tax & regulatory services, BDO India.

Amit Maheshwari of Ashok Maheswary & Associates said, "The court verdict would make the life of taxpayers simpler, and the fear that the established tax positions would be undermined is somewhat reduced."

The ICDS have 10 standards, which basically advance some income and postpone some expenses to arrive at the profitability of companies. Earlier, tax accounting was done on a conservative basis to recognise income as and when it arose.

"This is a big relief as the combination of IndAS, ICDS, and IFRS have led to a lot of confusion within the industry. To my mind, ICDS should ideally be deferred till IndAS settles in," said Girish Vanvari, partner and head – tax, KPMG India.

IndAS, or Indian Accounting Standards, are adopted by Indian companies and issued by the country's Accounting Standards Board. IFRS, or International Financial Reporting Standards, are global accounting standards issued by the IFRS Foundation and the International Accounting Standards Board.

[Source : Business Standard dt. 9-11-2017]

HC annuls 6 ICDS provisions, upholds its overall validity

SUMIT JHA
New Delhi, November 9

THE DELHI HIGH COURT has struck down six of the 10 provision under the Income Computation and Disclosure Standards (ICDS) as they overrode past judicial precedents. It, however, upheld the overall premise of this accounting principle for computing taxable income.

The introduction of ICDS had helped India improve nearly 50 places on 'ease of paying taxes' parameter in the World Bank's 'ease of doing business' ranking released earlier this month.

The Central Board of Direct Taxes (CBDT) introduced ICDS in 2016 as an alternate accounting method for the specific purpose of arriving at taxable income for those who are required to get their accounts audited as per the Income Tax Act, as distinct from the established practice of mercantile or cash accounting followed by corporates.

The CBDT had cited efforts by taxpayers to hide real taxable income under mercantile or cash accounting as the reason for introducing ICDS.

The overall impact of the 10 standards under ICDS was that it in most cases, the accrual of income is being accelerated while expenses are being delayed. "Most of the standards were issued to effectively overcome age-old accounting principles and norms that were being followed," Abhishek Goenka, leader corporate and international tax, PwC India said.

The Chamber of Tax Consultants, a body made of tax professional, had petitioned the Delhi HC challenging the constitutionality of ICDS. The court said ICDS amounted to enacting new accounting laws, which was the sole function of Parliament and couldn't be exercised by the central government.

For instance, the court struck down the first ICDS provision related to 'prudence'. According to this principle, a company may compute its profit based on the expectation that revenue from sales made earlier may not accrue to it. The petitioners contended that this concept had been completely done away with by the respondents, which was present in the earlier accounting standards. The court agreed with the argument and struck down the provision.

Similarly, the court annulled the second provision of ICDS related to valuation of inventories which eliminated the distinction between a continuing partnership business after dissolution from one which is discontinued upon dissolution. The court held that it was contrary to the decision of the Supreme Court earlier. "It (ICDS-II) fails to acknowledge that the valuation of inventory at market value upon settlement of accounts of the outgoing partner is distinct from valuation of the inventory in the books of the business which is continuing, the court said of the provision and held it to be ultra vires the Act.

The court also invalidated fourth ICDS provision saying: "ICDS-IV requires an assessee to recognise income from export incentive in the year of making the claim if there is 'reasonable certainty' of its ultimate collection. This is contrary to the decision of the Supreme Court in Excel Industries, and is, therefore, ultra vires the Act and struck down as such."

"This ruling upholds the overall validity of ICDS. Yet, and significantly, it strikes down several key standards on the grounds that the standards are contrary to rulings of the Supreme Court and that executive action cannot overturn these rulings. It is only an amendment in law that can make these changes," Goenka said.

The ruling came a day after the due date for corporate tax filings. For those covered by transfer pricing, the returns are due on November 30, and to that extent, it will also be important to analyse the impact on pending tax returns.

[Source : Financial Express dt. 10-11-2017]

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