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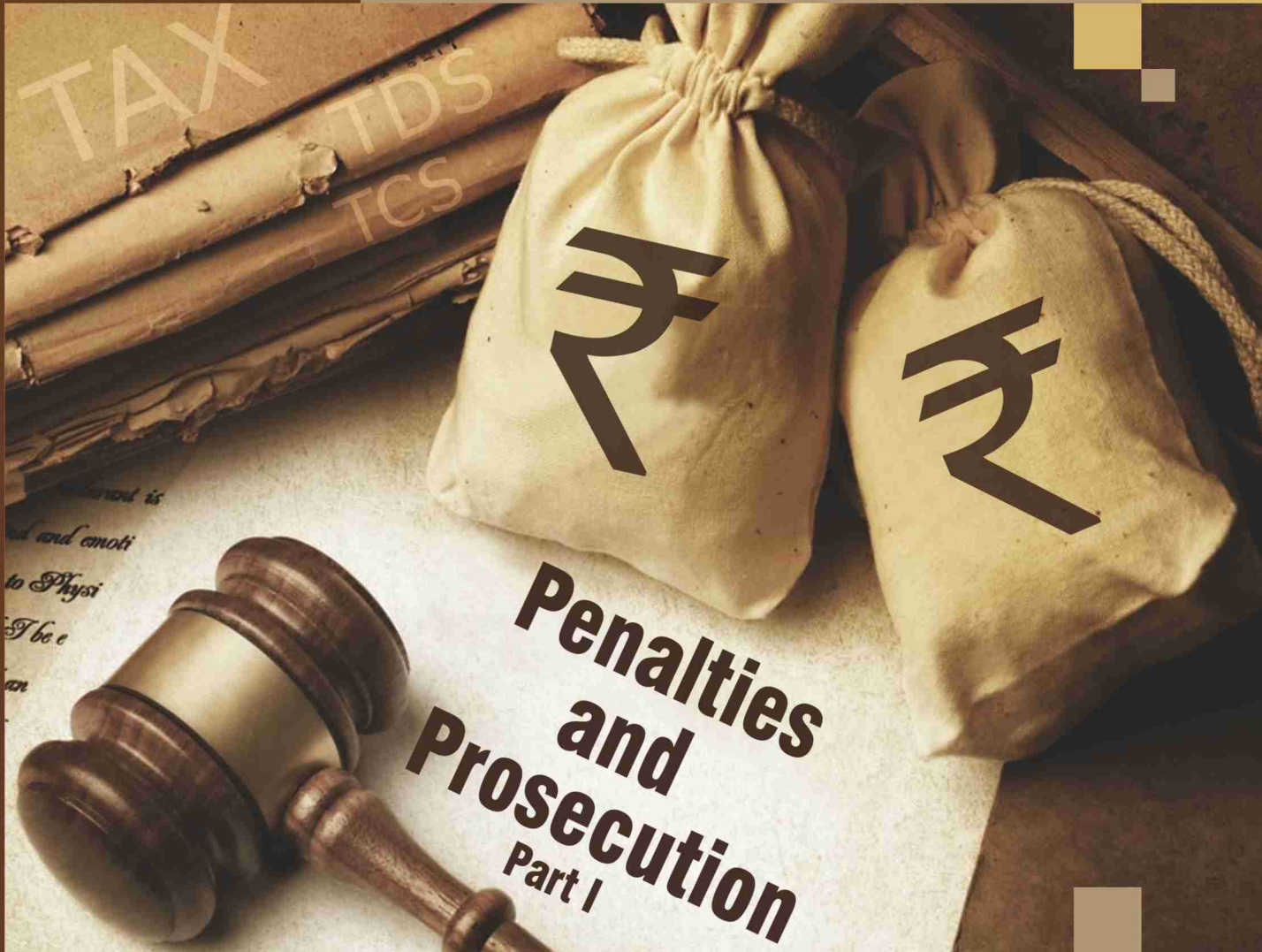


A Monthly Journal of
**The Chamber of
Tax Consultants**

Vol. VI | No. 7 April 2018

THE CHAMBER'S JOURNAL

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS



Penalties and Prosecution Part I

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45th Sir Jamshedji Kanga and Dr. Y. P. Trivedi National Moot Court Competition held jointly with GLC, Mumbai in Association with Rotary Club of Bombay on 6th & 7th April, 2018



Mr. Ajay R. Singh, President, along with CA Sanjeev Lalan, Chairman, Student Committee and Preliminary Round Judges



Mr Ajay Singh, President, felicitating Hon'ble Mr. G. S. Pannu, ITAT Member by offering flower bouquet

Quarter Final Round Judges



Mr. Ajay R. Singh, President along with Judges of Quarter final round



Mr Ajay R. Singh, President along with Hon'ble ITAT Members (Semi Final Round Judges) and Past Presidents, Chairman and other committee members



Winners of of 45th Sir Jamshedji Kanga and Dr. Y. P. Trivedi National Moot Court Competition along with Hon'ble Justice Mr K. R. Shriram of the Bombay High Court, Dr. Y. P. Trivedi, Mr. Ajay R Singh, President, CA Sanjeev Lalan, Chairman, Student Committee.



Best Speaker Ms. Anushka Mehta, Student of Government Law College, Mumbai .



Winner Team – Sastara University, Thanjavur



Runner up Team – Symbiosis Law School, Pune

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Editorial

In a democracy, right to protest is a very valuable right. Mahatma Gandhi propagated satyagraha but he laid down certain parameters for the satyagrahi i.e. the protestor. Nowadays, in the name of protests, the life in big cities or of the entire country is brought to a standstill in a very irresponsible manner. I am restraining myself from referring to any specific incident. However, we have witnessed protests seeking ban on a book which was not read by the protestors, a movie which was not seen by the protestors, recently protest against a decision of the Apex Court which was not read by the protestors. This irresponsible behaviour will undermine the value of right to protest. Here, I am tempted to quote from the Ramachandra Guha's book "India After Gandhi". At page No. 121, he refers to Dr. Ambedkar's last speech in the Constituent Assembly and says:

"Ambedkar ended his speech with three warnings about the future. The first concerned the place of popular protest in a democracy. There was no place for bloody revolution, of course, but in his view there was no room for Gandhian methods either. We must abandon the method of civil disobedience, non-co-operation and satyagraha [popular protest]. Under an autocratic regime, there might be some justification for them, but now, when constitutional methods of redress were available satyagraha and the like, said Ambedkar, were nothing but the grammar of anarchy and the sooner they are abandoned, the better for us."

The above message should be taken seriously, at least by those people who keep on invoking Dr. Ambedkar for their vested interests.

The present issue of Chamber's Journal brings out the special story on penalty and prosecution. Looking at the vastness of the subject, the Journal Committee has decided to publish the same in two parts. In this issue, we have made an exhaustive study of the subject. I hope this will come in handy to all professionals. I thank all the contributors to this issue for sparing their valuable time for the sake of Chamber's Journal.

K. GOPAL
Editor



From the President

Namaskar,

Dear Members & Readers,

Last year 2017-2018 was a wonderful year with buzz of activities, Seminars, Workshops, Lecture Series, RRC's, Debate Competition, successfully conducted with your support and I look forward for your continuous support for this year also. A new Financial Year begins with new hopes and vision. We learn from the past experience and move ahead with the experience and wisdom in continuing activities for future.

We are in a digital world & the Government of India is going digital in a big way across the board right from the PMO to the Gram Panchayat level. Simultaneously, global supply chains are going digital. We have to understand the implications of these initiatives on the running of businesses, large or small. Digital Transformation is the buzz word in India Incorporation.

Technology has changed the outlook towards the way we do business today. "Digital Transformation" has become an essential and critical chunk for any organisation with long-term business goals of sustenance. Consequently, Digital Transformation is changing the landscape of businesses in India ushering in new dynamics in the way transactions are conducted.

Companies are leveraging new technologies such as Artificial Intelligence, Robotics, Automation, Big Data and Cloud Services to optimise their business goals and services. With the Government of India Initiative of Digital India – India's landscape itself is going to witness, waves of radical changes in the coming years..

However one also needs to understand the other side of this digital transformation. Facebook is in a very uncomfortable spotlight at the moment. It is being investigated over its data-collection and privacy practices after information relating to as many as 50 million users wound up – via a third-party app - in the hands of a political research group which allegedly used it to target voters during the 2016 US presidential election.

Concern over this has prompted some Facebook users to check the amount and scope of data the social media giant has stored on them, using the download feature that Facebook provides.

And this has uncovered another area of controversy: Some Android users were shocked to discover that Facebook had far more detailed information about them than they knew, including phone calls and text messages data.

The Government of India has issued notice to social networking giant Facebook , seeking its response over the user data breach and details of measures it has put in place to ensure safety and prevent misuse of personal data.

A related news about one Ms. Urvashi Rautela (a bollywood Actress) who has registered a case of cheating with Mumbai Police alleging misuse of her Aadhaar card details. The actress has alleged that someone has used her identity details for booking a room in her name at a five-star hotel in Bandra. Notably, just a week ago, the Unique Identification Authority of India (UIDAI) said that there has been “absolutely no breach” of its database.

Similarly Former cricketer Anil Kumble’s wife has filed a cheating case against a private watch company based in Mumbai and a person working at a store in Bengaluru for misusing her PAN card details to conduct fraudulent transactions without her knowledge.

Ethics, culture, and related accountabilities touch every aspect of business, including the handling of customers data. There are a number of regulations that touch on data security and privacy but Data privacy and protection is not something that business, whether its banking, insurance, healthcare , hospitality etc., can ignore.

Digital disruption, data privacy, impact of artificial intelligence is all matter of concern in this fast changing technology. To great extent it is beyond ones control, as you don’t have a choice. Their very survival depends on their ability not only to adapt to evolving technological, demographic, and regulatory changes, but also how they address the associated risks. As Charles Darwin famously wrote over 150 years ago, “It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change.”

The CTC had organised jointly with Aurangabad Branch of WIRC of ICAI, GSTPAM and TPA, Aurangabad, a full day Seminar on Important Tax Issues on 17th March, 2018. We are thankful to Mr. Aalok Singh and other team members for organising a very educative seminar at Aurangabad.

45th Sir Jamshedji Kanga and Dr. Y.P. Trivedi National Tax Moot Court Competition was held jointly with Government Law College, Mumbai in association with Rotary Club of Bombay on 6th and 7th April, 2018. Sixty students from twenty law colleges, Universities, across the country, participated in the competition. The students from all the collages performed very well. The arguments from the students were superlative and judges appreciated the team work of the students. The Preliminary Round and Quarter Final rounds of the competition were judged by the practising professional members of the Chamber of Tax Consultants and Semi Final rounds of the competition were judged by Hon’ble ITAT Members. Final round was Judged by Hon. Justice Shri K. R. Shriram , of Hon. Bombay High Court. We are thankful to the Hon’ble Judge of Bombay High Court, ITAT Members, Dr. Y. P.Trivedi, ITAT Bar Association, all the professionals and, Students for lending their valuable support in making Moot Court Competition Successful.

The Special Story for the month is on “ Penalty & Prosecution- Part-I. I thank all the authors for sparing their valuable time and for their contribution to the Chamber’s Journal for this month.

It’s time to renew our ties with Chamber. Renewal Notices is already sent, and request members who have not renewed to do so at the earliest.

Jai Hind !

AJAY R. SINGH

President



Chairman's Communication

Dear Readers,

The bi-monthly monetary policy of the Reserve Bank of India has retained the repo rates at 6% and has slashed the inflation expectation sharply to 4.7-5.1% in the first half of 2018-19 and to 4.4% in second half, even as GDP growth for current fiscal is forecasted at 7.4% from 6.6% last fiscal. One wonders how the GDP of 7.4% would be achieved when there is a feeling of uncertainty amongst the entrepreneurs especially from the MSME segment! One of the significant announcements in the policy is deferment of Ind AS for the Banking Companies by one year.

While the fraud of a very large magnitude in a Public Sector Bank continues to haunt people at large, a large Private Sector Bank is in the news for the past few days due to loan controversy. More than the loan controversy it's a Corporate Governance issue. Though the Board and the Chairman of the Bank have given clean chit to the CEO, the moot point is that irrespective of the rules and regulations, good governance and ethical conduct depends on an individual. Therefore, despite changes in law and Corporate Governance frame work such episodes would continue to happen. SEBI very recently in its Board Meeting has adopted the new Corporate Governance frame work suggested by Uday Kotak Committee. Most of the suggestions made by Uday Kotak Committee have been accepted by the Board. Let us hope that this will enhance the overall quality of Governance of all the companies. This issue of the Journal covers an article on the subject in the regular column- "Corporate Law, Recent Developments".

Cricket is considered to be Gentleman's game. However the ball tampering episode and suspension of Steve Smith, David Warner and Cameron Bancrof for a year makes one feel that it is no longer so and it has lost its old glory. Amidst this ugly incidence of ball tampering, there is something to rejoice about ! India is doing exceedingly well in the ongoing Commonwealth Game and as on date of this communication it stands third in Gold Medal tally which is a matter of great pride for every Indian!

Topic of Penalty and Prosecution under Income-tax Act is of practical relevance for all the professionals and there have been quite a few changes in this area especially after enactment of Section 270A. Instances of prosecution also have increased in the recent past. Considering the fact that GST Act is a new law, penalty and prosecution under GST legislation is equally important and therefore the same has been included as part of the design. Considering the vastness of the subject, we are bringing out this issue in two parts. My sincere gratitude to CA Haresh Kenia for designing the first part and for overall co-ordination.

My gratitude to all the learned authors for sparing their valuable time despite their busy schedule and sharing their knowledge on the subject of penalty and prosecution.

VIPUL K. CHOKSI

Chairman – Journal Committee



K. C. Singhal, *Advocate*

Analysis of Penalty Provisions u/s. 271(1)(c) of Income-tax Act, 1961

Introduction

The provisions of section 271(1)(c) of Income-tax Act (hereafter referred to as 'the Act') deals with the levy of penalty for concealment of particulars of income or furnishing of inaccurate particulars of income. The relevant portion of this provision, as originally enacted, reads as under –

Failure to furnish returns, comply with notices, concealment of income etc.

271(1) If the Income-tax Officer or the Appellate Assistant Commissioner in the course of any proceedings under this Act, is satisfied that any person –

- (a) –
- (b) –
- (c) has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty,—
 - (i)
 - (ii)
 - (iii) in the cases referred to in clause (c), in addition to any tax payable

by him, a sum which shall not be less than twenty per cent but which shall not exceed one and a half times the amount of the tax, if any, which would have been avoided if the income as returned by such person had been accepted as the correct income.

This section has been amended from time-to-time in various years. The relevant amendments are –

- (a) The word 'deliberately' in the above section was omitted w.e.f. 1-4-1964;
- (b) The minimum amount of penalty was increased to the amount of tax evaded by Finance Act 1968;
- (c) Explanations 1 to 4 were inserted with effect from 1-4-1976;
- (d) Sub-section (IA) was also inserted with effect from 1-4-1976;
- (e) Explanation 5 was inserted w.e.f. 1-10-1984 and modified later on to restrict its operation to cases where search was initiated before 1-6-2007;
- (f) Explanation 6 was inserted w.e.f. 1-4-1989;
- (g) Explanation 7 was inserted w.e.f. 1-4-2002;

- (h) Explanation 5A was inserted w.e.f. 1-6-2007 i.e., in respect of cases where search was initiated on or after 1-6-2007. However, it was substituted later with retrospective effect from 1-6-2007 by Finance (No. 2) Act, 2009;
- (i) This section is no more applicable w.e.f. 2017 in view of new section 270A inserted by Finance Act, 2017.

It would therefore be appropriate to reproduce the relevant provisions of section 271(1)(c) as on 1-4-2016 as under –

- (a) –
- (b) –
- (c) has concealed the particulars of his income or furnished inaccurate particulars of such income, or
- (d) has concealed the particulars of the fringe benefits or furnished inaccurate particulars of such fringe benefits,

he may direct that such person shall pay by way of penalty, —

- (i) –
- (ii) –
- (iii) in the cases referred to in clause (c) [or clause (d)], in addition to tax, if any, payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or fringe benefits or the furnishing of inaccurate particulars of such income or fringe benefits.

Explanation 1 — Where in respect of any facts material to the computation of the total income of any person under this Act, —

- (A) such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner

(Appeals) or the Principal Commissioner or Commissioner to be false, or

- (B) such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is *bona fide* and that all the facts relating to the same and material to the computation of his total income have been disclosed by him,

then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed.

Explanation 2.— Where the source of any receipt, deposit, outgoing or investment in any assessment year is claimed by any person to be an amount which had been added in computing the income or deducted in computing the loss in the assessment of such person for any earlier assessment year or years but in respect of which no penalty under clause (iii) of this sub-section had been levied, that part of the amount so added or deducted in such earlier assessment year immediately preceding the year in which the receipt, deposit, outgoing or investment appears (such earlier assessment year hereafter in this Explanation referred to as the first preceding year) which is sufficient to cover the amount represented by such receipt, deposit or outgoing or value of such investment (such amount or value hereafter in this *Explanation* referred to as the utilised amount) shall be treated as the income of the assessee, particulars of which had been concealed or inaccurate particulars of which had been furnished for the first preceding year, and where the amount so added or deducted in the first preceding year is not sufficient to cover the utilised amount, that part of the amount so added or deducted in the year immediately preceding the first preceding year which is sufficient to cover such part of the utilised amount as is not so covered shall be treated to be the income of the assessee, particulars of which had been concealed or inaccurate particulars of which had been

furnished for the year immediately preceding the first preceding year and so on, until the entire utilised amount is covered by the amounts so added or deducted in such earlier assessment years.

Explanation 3.— Where any person fails, without reasonable cause, to furnish within the period specified in sub-section (1) of [section 153](#) a return of his income which he is required to furnish under [section 139](#) in respect of any assessment year commencing on or after the 1st day of April, 1989, and until the expiry of the period aforesaid, no notice has been issued to him under clause (i) of sub-section (1) of [section 142](#) or [section 148](#) and the Assessing Officer or the Commissioner (Appeals) is satisfied that in respect of such assessment year such person has taxable income, then, such person shall, for the purposes of clause (c) of this sub-section, be deemed to have concealed the particulars of his income in respect of such assessment year, notwithstanding that such person furnishes a return of his income at any time after the expiry of the period aforesaid in pursuance of a notice under [section 148](#).

Explanation 4 — For the purposes of clause (iii) of this sub-section,—

(a) the amount of tax sought to be evaded shall be determined in accordance with the following formula—

$$(A - B) + (C - D)$$

where,

A = amount of tax on the total income assessed as per the provisions other than the provisions contained in [section 115JB](#) or [section 115JC](#) (herein called general provisions);

B = amount of tax that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished;

C = amount of tax on the total income assessed as per the provisions contained in [section 115JB](#) or [section 115JC](#);

D = amount of tax that would have been chargeable had the total income assessed as per the provisions contained in [section 115JB](#) or [section 115JC](#) been reduced by the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished:

Provided that where the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished on any issue is considered both under the provisions contained in [section 115JB](#) or [section 115JC](#) and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D:

Provided further that in a case where the provisions contained in [section 115JB](#) or [section 115JC](#) are not applicable, the item (C - D) in the formula shall be ignored;

(b) where in any case the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished has the effect of reducing the loss declared in the return or converting that loss into income, the amount of tax sought to be evaded shall be determined in accordance with the formula specified in clause (a) with the modification that the amount to be determined for item (A - B) in that formula shall be the amount of tax that would have been chargeable on the income in respect of which particulars have been concealed or inaccurate particulars have been furnished had such income been the total income;

(c) where in any case to which *Explanation 3* applies, the amount of tax sought to be evaded shall be the tax on the total income

assessed as reduced by the amount of advance tax, tax deducted at source, tax collected at source and self-assessment tax paid before the issue of notice under section 148.

Explanation 5.— Where in the course of a search initiated under section 132 before the 1st day of June, 2007, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article or thing (hereafter in this *Explanation* referred to as assets) and the assessee claims that such assets have been acquired by him by utilising (wholly or in part) his income —

- (a) for any previous year which has ended before the date of the search, but the return of income for such year has not been furnished before the said date or, where such return has been furnished before the said date, such income has not been declared therein; or
- (b) for any previous year which is to end on or after the date of the search,

then, notwithstanding that such income is declared by him in any return of income furnished on or after the date of the search, he shall, for the purposes of imposition of a penalty under clause (c) of sub-section (1) of this section, be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income, unless —

- (1) such income is, or the transactions resulting in such income are recorded, —
 - (i) in a case falling under clause (a), before the date of the search, and
 - (ii) in a case falling under clause (b), on or before such date,

in the books of account, if any, maintained by him for any source of income or such income is otherwise disclosed to the Principal Chief Commissioner or Chief Commissioner or [Principal Commissioner or Commissioner] before the said date; or

- (2) he, in the course of the search, makes a statement under sub-section (4) of section 132 that any money, bullion, jewellery or other valuable article or thing found in his possession or under his control, has been acquired out of his income which has not been disclosed so far in his return of income to be furnished before the expiry of time specified in sub-section (1) of section 139, and also specifies in the statement the manner in which such income has been derived and pays the tax, together with interest, if any, in respect of such income.

Explanation 5A.— Where, in the course of a search initiated under section 132 on or after the 1st day of June, 2007, the assessee is found to be the owner of—

- (i) any money, bullion, jewellery or other valuable article or thing (hereafter in this *Explanation* referred to as assets) and the assessee claims that such assets have been acquired by him by utilising (wholly or in part) his income for any previous year; or
- (ii) any income based on any entry in any books of account or other documents or transactions and he claims that such entry in the books of account or other documents or transactions represents his income (wholly or in part) for any previous year,

which has ended before the date of search and, —

- (a) where the return of income for such previous year has been furnished before the said date but such income has not been declared therein; or
- (b) the due date for filing the return of income for such previous year has expired but the assessee has not filed the return,

then, notwithstanding that such income is declared by him in any return of income furnished on or after the date of search, he shall, for the purposes of imposition of a penalty under clause (c) of sub-section (1) of this section, be deemed to have concealed the particulars of his

income or furnished inaccurate particulars of such income.

Explanation 6.— Where any adjustment is made in the income or loss declared in the return under the proviso to clause (a) of sub-section (1) of [section 143](#) and additional tax charged under that section, the provisions of this sub-section shall not apply in relation to the adjustment so made.

Explanation 7— Where in the case of an assessee who has entered into an international transaction 27 or specified domestic transaction] defined in [section 92B](#), any amount is added or disallowed in computing the total income under sub-section (4) of [section 92C](#), then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in [section 92C](#) and in the manner prescribed under that section, in good faith and with due diligence.

(1A) Where any penalty is imposable by virtue of *Explanation 2* to sub-section (1), proceedings for the imposition of such penalty may be initiated notwithstanding that any proceedings under this Act in the course of which such penalty proceedings could have been initiated under sub-section (1) have been completed.

(1B) Where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under clause (c) of sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings under the said clause (c).

(2) When the person liable to penalty is a registered firm or an unregistered firm which has been assessed under clause (b) of [section 183](#), then notwithstanding anything contained in the other provisions of this Act, the penalty imposable under sub-section (1) shall be the same amount as would be imposable on that firm if that firm were an unregistered firm.

(3) [Omitted by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1-4-1989.]

(4) If the Assessing Officer or the Commissioner (Appeals) in the course of any proceedings under this Act, is satisfied that the profits of a registered firm have been distributed otherwise than in accordance with the shares of the partners as shown in the instrument of partnership on the basis of which the firm has been registered under this Act, and that any partner has thereby returned his income below its real amount, he may direct that such partner shall, in addition to the tax, if any, payable by him, pay by way of penalty a sum not exceeding one and a half times the amount of tax which has been avoided, or would have been avoided if the income returned by such partner had been accepted as his correct income; and no refund or other adjustment shall be claimable by any other partner by reason of such direction.

(5) Any reference in this section to the income shall be construed as a reference to the income or fringe benefits, as the case may be, and the provisions of this section shall, as far as may be, apply in relation to any assessment in respect of fringe benefits also.

Hereafter, my effort will be to discuss the important issues relating to this section under various heads.

Nature of penalty and burden of proof

At the outset, it would be appropriate to point out that the provisions of clause (c) of section 271 as originally enacted were identical to the provisions section 28(1)(c) of Indian Income-tax Act, 1922. The nature of proceedings under

section 28(1)(c) was considered by the Hon'ble Apex Court in case of *CIT vs. Anwar Ali (1970) 76 ITR 696 SC* wherein it was held that **nature** of penalty proceedings was penal in nature and therefore **burden** was on the revenue to prove that assessee had concealed the particulars of income or furnished inaccurate particulars of income. In coming to this conclusion, the court took into consideration the legislative intent by referring to the word "deliberately" used in that section as well as its decision in the case of *Hindustan Steels Ltd. vs. State of Orissa 83 ITR 26 SC*. It was further held that penalty could not be levied merely on the ground that explanation of assessee was false. The revenue must prove that assessee **consciously** concealed the income. This decision was followed by the High Courts as well as the Tribunal while deciding the cases with reference to penalty u/s. 271(1)(c) of the 1961 Act. This view was reiterated in case of *Sir Shadi Lal Sugar & General Mills Ltd. vs. CIT 168 ITR 705 SC*.

However, after the amendment of section 271(1)(c) w.e.f. 1-4-1964, the question arose whether decision in case of Anwar Ali could be applied? Two major changes were brought by Finance Act 1964 – firstly, the word deliberately was omitted and Explanation was added to the effect that where the returned income is less than 80% of assessed income then assessee shall be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income unless the assessee proves that the failure to file the correct income did not arise from any fraud or any gross or wilful neglect on his part. This aspect was examined by the Apex Court in case of *CIT vs. Muaddilal Ram Bharose (1987) 165 ITR 14 SC* with reference to A.Y. 1965-66 where Explanation to the above section (as was applicable to that year) was in force. The Hon'ble Court noted that the object and intent of the Legislature in omitting the word 'deliberately' from clause (c) of section 271(1) and adding an Explanation thereto by the Finance Act, 1964, was to bring about a change in the existing law regarding the levy of penalty so as to shift the burden of proof from the department to the

assessee in the class of cases where the returned income of the assessee was less than 80 per cent of the assessed income. Accordingly, it was **held** that that where the Explanation applies, the **onus is shifted** to assessee to prove failure to file the correct income did not arise from any fraud or any gross or wilful neglect on his part. However, it was held that Explanation only raises a presumption but the presumption is rebuttable one and if the fact-finding body on relevant and cogent materials comes to the conclusion that in spite of the presumption the assessee was not guilty, then penalty could not be sustained. In other words, in the absence of proper explanation by the assessee, penalty could be legally imposed. This view was **reiterated** in *Chuharmal vs. CIT 172 ITR 250 SC*, *CIT vs. K. R. Sadayappan 185 ITR 149 SC Addl. CIT vs. Jeevan Lal Sah 205 ITR 244 SC*; *B.A. Balasubramaniam & Bros 236 ITR 977 SC*.

However, subsequently, the Hon'ble Apex Court in the case of *K. C. Builders vs. ACIT 265 ITR 562 SC* held that the word 'conceal' in this section inherently carries with it the element of *mens rea* and therefore the burden is on the revenue to prove that assessee has consciously concealed the particulars or furnished inaccurate particulars of income.

Similar view was taken by the Hon'ble Apex Court, in the case of *Dilip N. Shroff 291 ITR 521 SC*, by holding— (i) that levy of penalty is not automatic but is discretionary in nature which is to be exercised keeping in view the relevant factors emphasised in Explanation 1. It was also held that legal fiction would be attracted only where finding is given by AO that factors enumerated in the Explanation are satisfied, (ii) the expression 'conceal' is of great importance. It signifies a deliberate act or omission on the part of the assessee, (iii) primary burden of proof, therefore, is on the revenue, (iv) Assessing Officer should not begin with the presumption that he is guilty, (v) Once the primary burden of proof is discharged, the secondary burden of proof would shift on the assessee. [This view was applied in its later decision in case of *T. Ashok Pai vs. CIT 292 ITR 11 SC*].

At this stage, it may be pointed out that earlier decisions of the Court in case of *CIT vs. Muaddil Ram Bharose and Jeevan Lal Sah* (*supra*) were not cited before the Court by the counsel for revenue.

However, subsequently, the Hon'ble Apex Court in the case of *UOI vs. Dharmendra Textiles Processors 306 ITR 277 SC* [Larger Bench] did not agree with the decision in *Dilip N. Shroff* (*supra*) and held that the penalty under the said section is a **civil liability. Wilful concealment is not an essential ingredient for attracting the civil liability as is the case in the matter of prosecution under section 276C.**

In view of the above discussion, it is clear that post Finance Act, 1964, **the nature of proceeding u/s. 271(1)(c) is neither criminal nor quasi criminal and therefore, the revenue is not required to prove the mens rea** i.e., consciousness on the part of assessee to evade tax liability.

However, that does not mean that penalty is automatic in every case where addition is made by AO. The revenue is still required to prove that conditions stated in such section are satisfied. The conditions are that assessee—(i) has concealed the particulars of income, OR (ii) has furnished inaccurate particulars of income. This view has been taken by the Apex Court in *UOI vs. Rajasthan Spg. & Wvg. Mills 180 Taxman 609 SC* by observing—

“The decision in Dharamendra Textile Processors' case (*supra*) must, therefore, be understood to mean that though the application of section 11AC would depend upon the existence or otherwise of the conditions expressly stated in the section, once the section is applicable in a case, the concerned authority would have no discretion in qualifying the amount and penalty must be imposed equal to the duty determined under sub-section (2) of section 11A.”

Reference can also be made to its subsequent decision in *CIT vs. Atul Mohan Bindal 317 ITR 1 SC* wherein, after considering its earlier decision in Dharmendra Textile's case, it was held in para

14 as “It goes without saying that for applicability of section 271(1)(c), conditions stated therein must exist”.

In view of the same, the **final view** appears to be that that—

- (a) Nature of proceedings u/s. 271(1)(c) is neither criminal nor quasi criminal but is that of civil liability.
- (b) Though *mens rea* on the part of assessee is not required to be proved by the revenue yet it must prove that conditions specified in section 271(1)(c) are satisfied.
- (c) In other words, the revenue still must prove that assessee has either concealed the particulars of income or has furnished inaccurate particulars of income.
- (d) *Explanation-1* is part of section 271 and therefore a presumption is raised about the concealment of particulars of income though it is rebuttable one. Hence, wherever an addition or disallowance is made, the assessee must rebut the presumption by offering an explanation to show that all the relevant material for computing the income had been disclosed in assessment proceeding. Once such onus is discharged, it shifts to revenue to prove otherwise in order to bring the case within the four corners of requirement of law.

Satisfaction for initiating such proceeding

A bare look at the provisions of section 271(1)(c) of the Act as originally enacted shows that satisfaction of the concerned tax authority to the effect that the assessee has either concealed the particulars of income or furnished inaccurate particulars of income is the condition precedent for initiation of penalty proceedings and such satisfaction must be arrived at in the course of any proceeding under the Act. Such provisions are identical to the provisions of section 28(1)(c) of 1922 Act and therefore decision of the Apex Court

in case of *CIT vs. Angidi Chettiar* 44 ITR 739 SC as well as in *D. M. Manasvi* 86 ITR 557 (SC) would be relevant. In the later decision, it was held that – what is contemplated by clause (1) of section 271 is that the Income-tax Officer or the Appellate Assistant Commissioner should have been satisfied in the course of proceedings under the Act regarding matters mentioned in the clauses of that sub-section. In other words, the officer should record his satisfaction as to concealment of particulars of income or furnishing of inaccurate particulars of income. It was further held that it would not be correct to equate the satisfaction with the actual issue of notice. Thus, in absence of such satisfaction, the levy of penalty would be null & void. Following these decisions, various High Courts and the Tribunal have declared the levy of penalty as illegal where the assessing officer failed to record such satisfaction.

Faced with such situation, the legislature inserted sub-section (1B) by Finance Act 2008 with retrospective effect from 1-4-1989 which provides that direction in the order of assessment for initiating penalty proceeding would constitute the satisfaction. In other words, now the officer is not required to record such satisfaction as discussed above. It would be sufficient compliance of this section if direction is given in the assessment order for initiation of penalty proceedings.

Scope of sub-section (1B) has been examined by the various Courts. The same is being discussed as under:

The Constitutional validity of the above amendment was challenged before the Hon'ble Delhi High Court, in case of *Madhushree Gupta vs. UOI* 317 ITR 107. It upheld the Constitutional validity by reading down the provisions to the effect that satisfaction in the course of assessment proceedings is must but need not be in the manner as was necessary in the light of earlier legal position **but it must be discernible from the facts stated in the assessment order**. In other words, the facts narrated in the assessment order must indicate that assessee either failed to disclose material facts or facts disclosed by him were inaccurate.

In its subsequent decision in *CIT vs. ECS Ltd.* 336 ITR 162 Del., it explained the effect of the above decision by observing – **“The net effect of the said judgment is that even when the Assessing Officer has not recorded his satisfaction in explicit terms, the assessment order should indicate that the Assessing Officer had arrived at such a satisfaction.”** The decision of Hon'ble Delhi HC can be gone through to notice that facts of the case were enough from which it could be said that satisfaction was discernible.

However, all other High Courts were not concerned with the Constitutional validity of such provisions but decided the issue as stated hereafter –

Hon'ble Punjab & Haryana High Court, in case of *CIT vs. Pearey Lal & Sons* [2009] 177 Taxman 302 (Punjab & Haryana), was considered with a situation where the AO mentioned in order of assessment – “penalty proceedings under sections 271(1)(c) and 273(2)(a) are being initiated separately”. After considering the provisions of sub-section (1B), it was held that absence of satisfaction could not be inferred from the fact that only words used in the assessment order are that proceedings were being separately initiated.

The Hon'ble Gujarat HC followed the above decision of Punjab & Haryana High Court in case of *Snita Transport P. Ltd.* 221 Taxman 217 (Guj.)

Hon'ble Uttarakhand HC, in case of *CIT vs. Sanjay Ghai* [2013] 34 taxmann.com 208 was concerned with a situation where the AO stated in the order – “Penalty proceedings u/s. 271(1)(c) of the I.T. Act, 1961 have also been initiated for furnishing inaccurate particulars with regard to income”. The Court held that it constitute deemed satisfaction in terms of sub-section (1B).

Hon'ble Karnataka HC in case of *Manjunath Cotton & Ginning Factory* [2013] 359 ITR 565 (Kar.) also took similar view as that of Delhi high court by observing as under –

A direction to initiate proceedings under section 271(1)(c) is a *sine qua non* for the

Assessing Officer to initiate the proceedings because of the deeming provision contained in section 1(B). The said deeming provisions are not applicable to the orders passed by the Commissioner (Appeals) and the Commissioner [Para 63].

Even if there is no specific finding regarding the existence of the conditions mentioned in section 271(l)(c), at least the facts set out in Explanation 1(A) & (B) it should be discernible from the said order which would by a legal fiction constitute concealment because of deeming provision.

The direction referred to in Explanation 1B to section 271 should be clear and without any ambiguity. If the Assessing Officer has not recorded any satisfaction or has not issued any direction to initiate penalty proceedings in appeal, but the appellate authority records satisfaction, then the penalty proceedings have to be initiated by the appellate authority and not the Assessing Authority.

However, Hon'ble Karnatka HC in its later decision in *CIT vs. MWP Ltd.* 264 CTR 502 clarified and held that mere mention of 'Penalty proceedings under section 271(1)(c) initiated separately' in assessment order, does not amount to a direction under section 271(1)(c) for levy of penalty.

In the case of *Triveni Engineering & Industries Ltd.* 369 ITR 660 (All.), the Court held that where AO directed for initiation of penalty proceedings on account of various additions but failed to make such direction in respect of one addition/disallowance then penalty could not be levied in respect of such addition/disallowance.

In the case of *CIT vs. Lotus Construction* 370 ITR 475 (AP), Hon'ble High Court held that in the absence of any direction to initiate penalty, the notice u/s. 271(1)(c) was invalid.

Thus, the legal position emerging from these decisions is not unanimous. **In my opinion,**

satisfaction or deemed satisfaction contemplated by the aforesaid provisions was and continues to be a jurisdictional matter and therefore the decision of Hon'ble Delhi High Court in case of **Madhushree Gupta** appears to be the most appropriate one because the affected party must know either from the facts stated in the order or from the direction whether AO intends to initiate proceedings for failure to disclose the particulars of income or for furnishing inaccurate particulars of income. The Hon'ble Court, after considering the legislative intent, held that any contrary view would be in violation of Article 14 of the Constitution of India. Though no format or manner is required but such jurisdictional fact must be **discernible** from the order of assessment only.

Thus, **in my view**, mere mentioning that “penalty proceedings are being initiated separately” even does not amount to direction. The expression “initiate penalty proceedings u/s. 271(1)(c)” will not meet the legal requirement unless such deemed satisfaction discerns from the facts recorded by AO. The decisions of Hon'ble Punjab & Haryana High Court and Guj. HC mentioned earlier, in my view, needs to be reviewed in appropriate cases.

Notice u/s. 271(1)(c)

At the outset, it may be mentioned that issue of notice is not a jurisdictional matter and therefore need not be issued in the course of assessment proceeding as held by the Hon'ble Apex Court in *D. M. Manasvi* 86 ITR 557 (SC) though satisfaction has to be recorded in course of assessment proceeding. However, notice has to be issued before levying penalty since principles of natural justice requires that the person against whom action has to be taken must be heard in respect of the charges framed against him. Thus, the notice can be issued even after the completion of assessment.

Notwithstanding the provisions sub-section (1B) of section 271, **in my opinion**, the assessing officer is not precluded from satisfying himself about the

charge being framed against the assessee. One cannot be punished for a charge which was not made against him. Thus, in the show cause notice, the AO must show the exact allegation or charge which is to be answered by the assessee. In other words, if the notice is issued alleging concealment of particulars of income then penalty cannot be levied on the ground that assessee had furnished inaccurate particulars of income. Reliance is placed on the decision of Hon'ble Karnataka High Court in case of *Manjunath Cotton & Ginning Factory [2013] 359 ITR 565 (Kar.)* where the AO did not specify the exact charge in the notice issued, penalty is not leviable.

After the insertion of the provisions sub-section (1B) of section 271, it has been held by some High Courts to the effect that mere direction to issue notice u/s 271 would be sufficient compliance even though no specific charge is mentioned therein. In such cases, it becomes more necessary for the assessing officer to specify the exact charge in the notice since his satisfaction, at least, must be apparent from such notice. The relevance of notice, **in my opinion**, would depend on situation of each case-

- (a) There may be cases where the AO simply says that "penalty proceedings are being initiated separately" or "issue notice u/s. 271(1)(c)". In such cases, it becomes necessary for the AO to specify the exact charge. Failure on the part of AO in this regard would render the levy of penalty illegal as held by various courts and the tribunal in various cases unless the charge for which penalty is levied is in consonance with charge discernible from the facts stated in the order.
- (b) There may be cases where notice is issued for concealment of particulars income while the facts discernible from the order indicate furnishing of inaccurate particulars of income or vice versa. In such cases, penalty levied on the basis of charge in the notice would be illegal.
- (c) There may be cases where direction has

been issued for a specific charge but the AO forgets to strike of irrelevant charge in the printed notice but penalty is also levied for the charge for which direction was issued then in such cases, in my opinion, penalty levied cannot be deleted on the technical lapse on the part of AO.

Before parting with this issue, it may be pointed out that where basis of satisfaction is changed by the CIT(A) then satisfaction has to be recorded by the CIT(A) and penalty is also to be levied by him and not by AO as held by hon'ble Karnataka high court in case of *Manjunath Cotton & Ginning Factory [2013] 359 ITR 565 (Kar)*. Reference can also be made to the decision of Hon'ble All HC in *Motilal Shamsundar vs. CIT [1972] 84 ITR 186 (All)* where similar view has been taken.

Levy of penalty on merits

As far as general position in law is concerned, reference can be made directly to the decision of the Hon'ble apex court in the case of *Reliance Petro Products (P) Ltd. 322 ITR 158 SC* wherein it was held that penalty cannot be levied merely on the ground that some additions or disallowances have been made by the assessing officer. The revenue, in order to impose penalty under this section, must prove that assessee has either concealed the particulars of income or furnished inaccurate particulars of income. In short, the following propositions emerge from this decision—

- (a) There has to be concealment of the particulars of the income or furnishing of inaccurate particulars of income of assessee. [Para 7]
- (b) Everything would depend upon the return filed, because that is the only document, where the assessee can furnish the particulars of his income. When such particulars are found to be inaccurate, the liability would arise. [Para 8]
- (c) The word 'particulars' must mean the details supplied in the return, which are not accurate, not exact or correct, not according to truth or erroneous. [Para 9]

- (d) A mere making of the claim, which is not sustainable in law by itself will not amount to furnishing of inaccurate particulars regarding the income of the assessee. Such claim made in the return cannot amount to the inaccurate particulars [Para 9].
- (e) Merely because the assessee had claimed the expenditure, which claim was not accepted or was not acceptable to the revenue, that, by itself, would not attract the penalty under section 271(1)(c) [Para 10].

This judgment is relevant and appropriate where the allegation is regarding furnishing of inaccurate particulars of income. The cases regarding concealment of particulars of income must be considered in the light of Explanation-1 attached with this section w.e.f. 1-4-1989. This *Explanation* provides deeming provision to the effect that where the assessee fails to offer an explanation or offers an explanation which is found to be false OR he fails to substantiate and fails to prove that such explanation is *bona fide* and that all the relevant facts relating to the additions made have been disclosed by him.

Reference can also be made to the decision of the Hon'ble Apex Court in the case of *T. Ashok Pai-v-CIT 292 ITR 211 SC* wherein it was observed—

"The term '**inaccurate particulars**' is not defined. Furnishing of an assessment of value of the property may not by itself be furnishing of inaccurate particulars. Even if the *Explanations* are taken recourse to, a finding has to be arrived at having regard to clause (A) of *Explanation 1* to section 271(1)(c) that the explanation offered by an assessee, in the event, he offers one was false. He must be found to have failed to prove that such explanation is not only not bona fide but all the facts relating to the same and material to the income were not disclosed by him. Thus, apart from his *explanation* being not *bona fide*, it should be found as of fact that he has not disclosed all the facts which was material to the computation of his income [Para 16].

It is trite that if an *explanation* given by the assessee with regard to the mistake committed by him has been treated to be *bona fide* and it has been found as of fact that he had acted on the basis of wrong legal advice, the question of his failure to discharge his burden in terms of *Explanation* appended to section 271(1)(c) would not arise [Para 13].

The *explanation*, having regard to the decision of the Supreme Court, must be preceded by a finding as to how and as to in what manner he furnished the particulars of his income. It is beyond any doubt or dispute that for the said purpose the ITO must arrive at its satisfaction in this behalf [Para 17].

At this stage, it would be appropriate to refer to decisions of the Apex Court applicable prior to insertion of *Explanations* w.e.f. 1-4-1976.

Prior to insertion of this Explanation, the legal position was governed by the decision of the Hon'ble Apex Court in the case of *Anwar Ali 76 ITR 696 SC & Sir Shadilal Sugar & General Mills Ltd 168 ITR 705 SC* wherein it was held that –

- (i) The burden is on the department to prove that a particular amount is a revenue receipt;
- (ii) It would be perfectly legitimate to say that the mere fact that the *explanation* of the assessee is false does not necessarily give rise to the inference that the disputed amount represents income;
- (iii) It cannot be said that the finding given in the assessment proceedings for determining or computing the tax is conclusive. However, it is good evidence.
- (iv) Before penalty can be imposed the entirety of circumstances must reasonably point to the conclusion that the disputed amount represented income and that the assessee had consciously concealed the particulars of his income or had deliberately furnished inaccurate particulars.

- (v) Mere agreeing to additions by the assessee, it did not follow that the amount agreed to be added was concealed income. There may be hundred and one reasons for such admissions, i.e., when the assessee realised the true position it did not dispute certain disallowances but that did not absolve the revenue from proving the *mens rea* of quasi-criminal offence.
- (vi) It is for the income-tax authority to prove that a particular receipt is taxable. If, however, the receipt is accepted and certain amount is accepted as taxable, it can be added but from that it does not follow that it is accepted by the assessee that it has deliberately furnished inaccurate particulars or concealed any income.

Legal position w.e.f. 1-4-1976.

Explanations 1 to 4 were inserted in section 271 by Taxation Laws (Amendment) Act, 1975 w.e.f. 1-4-1976. *Explanation 1* provides deeming provisions relating to concealment of income. It is in two parts. Clause A provides that where any amount is added or disallowed by the AO then the same shall be deemed to represent the concealed income if the assessee fails to offer an explanation or explanation offered is found to be false. Clause B provides that where assessee fails to substantiate the explanation and fails to prove that such explanation is *bona fide* and that all the relevant facts have been disclosed by him, then the same shall be deemed to represent concealed income.

The Hon'ble Supreme Court had to consider the impact of *Explanation 1(B)* in the case of *K. P. Madhusudhanan vs. CIT 251 ITR 99 SC*. Their Lordships observed to the effect that the *Explanation to section 271(1)(c)* is a part of section 271. Their Lordships disapproved the decision of Hon'ble Bombay HC in *P. M. Shah [1993] 203 ITR 792* wherein the court held that *Explanation to section 271* was not automatic unless specifically invoked by the AO in the notice issued. Hence, it was held by the Apex Court that when the

ITO or the AAC issues to an assessee a notice under section 271, he makes the assessee aware that the provisions thereof are to be used against him. Therefore, the assessee is **deemed** to have concealed the particulars of his income **unless** he proves that the failure to return the correct income did not arise from any fraud or neglect on his part. The assessee is, therefore, by virtue of the notice under section 271 put to notice that if he does not prove, in the circumstances stated in the *Explanation*, that his failure to return his correct income was not due to fraud or neglect, he shall be deemed to have concealed the particulars of his income or furnished inaccurate particulars thereof. Hence, no express invocation of the *Explanation to section 271* in the notice under section 271 is, in our view, necessary before the provisions of the *Explanation* therein are applied. Consequently, it was observed that the earlier decision in *Sir Shadilal Sugar & General Mills Ltd (supra)* is no more applicable after insertion of *Explanation to section 271*.

It would also be relevant to discuss the later decision of the Hon'ble Apex Court in *Mak Data (P) Ltd. vs. CIT 358 ITR 593 SC* wherein similar view has been taken by holding that--

"*Explanation to Section 271(1)* raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the *explanation*, has been discharged by him, the onus shifts on the revenue to show that the amount in question constituted the income and not otherwise".

In view of the above, the Hon'ble Court upheld the levy of penalty where the assessee surrendered the unexplained share application money amount in the course of assessment proceedings by stating that such surrender was being made in order to avoid litigation and to buy peace.

Thus, where the assessee has offered a proper explanation regarding particulars of income

or the explanation given is not found to be false then penalty is not leviable merely because the addition/disallowance is made by AO. Similarly, penalty cannot be levied merely because a legal claim has been disallowed.

Reference can be made to the decision of the Apex Court in case of *Reliance Petro Products (P) Ltd.* 322 ITR 158 SC where it was held that penalty could not be levied merely on the ground that claim regarding interest was held to be disallowable. This decision has been followed by various High Courts as well as tribunals. [*CIT vs. Neenu Gupta* 357 ITR 525 (Delhi); *CIT vs. Anant Overseas* 229 Taxman 433 (Del); *Shervani Hospitalities Ltd. vs. CIT* 261 CTR 449 (Del); *CIT vs. Bal Kishan Dhawan* 223 Taxman 216 (PH); *CIT vs. Tudor Knitting Works (P.) Ltd* 366 ITR 236 (PH); *CIT vs. Kisan Sahakari Chini Mills Ltd* 226 Taxman 208 (All); *CIT vs. G. K. Properties* 377 ITR 417 (AP); *CIT vs. Chittorgarh Kendriya Sahakari Bank Ltd* 41 taxmann.com 11 (Raj.); *CIT vs. Oshwal Education Trust* 369 ITR 91 (Guj.); *CIT vs. H.P. State Forest Corpn. Ltd* 340 ITR 204 (HP); *CIT vs. Manjunatha Cotton & Ginning Factory* 359 ITR 565 (Kar);

Where addition is based on estimate basis, it was held that penalty was not leviable. [*Naresh Chand Agarwal vs. CIT* 357 ITR 514 (All); *CIT vs. P. Rojas* 356 ITR 703 (Mad.); *Mahendra Singh Khedla* 252 CTR 453 (Raj.)

Where addition was based merely by applying the DVO's report under the provisions of section 50C, the Court held that no penalty was leviable. [*CIT vs. Madan Theatres Ltd* 260 CTR 75 (Cal.); *CIT vs. Fortune Hotels and Estates (P.) Ltd* 232 Taxman 481 (Bom.)] See also SC decision in case of *Dilip N. Shroff* 291 ITR 519 SC.

Where addition was based on mere stock valuation in the absence of adverse material, it was held that penalty was not leviable. *ITO vs. Ramsons* [2017] 85 taxmann.com 90 (Bom.); *CIT vs. Rudrappan & Co* 21 Taxman 425 (Madras); *CIT vs. Nokia India Pvt. Ltd.* 343 ITR 434 (Del.).

However, where excess stock was found on actual verification in survey, penalty was held to be

leviable. [*Ramesh Chand Gupta vs. ITAT* 244 ITR 320 (PH); *CIT vs. Das Jewellers* 258 ITR 668 (Del); *Seth Daumal Narsumal vs. CIT* 153 ITR 78 (MP); *Tej Bhan Cotton Ginning & Pressing Factory vs.* 198 Taxman 153 (PH).

Valuation by DVO – Where addition is based merely on account of difference in cost declared by assessee and DVO's report, it has been held that penalty is not leviable. [*CIT vs. Vasant K. Handigund* 327 ITR 233 (Kar.); *T. P. K. Ramalingam vs. CIT* 211 ITR 520 (Mad.); However, where assessee filed revised return on the basis of DVO report, penalty was held leviable in *J. Sumermal (HUF) vs. ACIT* 195 Taxman 210 (Kar.).

Where computation of income under a particular head but shifted by AO to different, it was held that penalty cannot be levied. [*CIT vs. Auric Investment & Securities Ltd* 310 ITR 121 (Del.); *CIT vs. Bennett Coleman & Co. Ltd* 215 Taxman 93 (Bom); *CIT vs. Hira Lal Doshi* 383 ITR 19 (Bom); *CIT vs. Amit Jain* 351 ITR 74 (Del); *CIT vs. Jaswinder Singh Ahuja* 351 ITR 262 (Del); *CIT vs. Sunil Chand Gupta* [2013] 40 taxmann.com 307 (All.);

Where addition is based on debatable issue, no penalty is leviable. [*CIT vs. Hemalatha Rajan* 396 ITR 515 (Mad.); *CIT vs. Gurdaspur Co-operative Sugar Mills Ltd* 354 ITR 27 (PH); *CIT vs. Bacardi Martini India Ltd.* 288 ITR 585 (Del); *CIT vs. Kiranjit Foils Ltd.* [2010] 2 taxmann.com 312 (Delhi); *CIT vs. Lakhani India Ltd* [2010] 1 taxmann.com 164 (PH); *CIT vs. Prakash S. Vyas* 232 Taxman 352 (Guj); *CIT vs. Nayan Builders & Developers* 368 ITR 722 (Bom); *CIT vs. Ankita Electronics (P.) Ltd.* 379 ITR 50 (Kar.) *Navneet vs. CIT* 273 ITR 482 (MP); *Anoopgarh Kraya Vikraya Sahakari Samiti Ltd. vs. ACIT* 232 Taxman 256 (Raj.);

Retrospective amendment – no penalty [CIT vs. Yahoo India (P.) Ltd. 216 Taxman 66 (Bom.)]

In the case of *PriceWaterhouseCoopers (P) Ltd.* 348 ITR 306 SC, the assessee specifically stated in the audit report that gratuity payable was not allowable as deduction but by mistake did not make adjustment while computing its income.

On the peculiar facts of the case, the Court held that it was a computational error which could be committed even by tax expert. It was also noticed that all necessary particulars of income had been disclosed in the audit report and the report itself stated that such expenditure was disallowable. Hence, it was held that penalty was not leviable.

In the case of *CIT vs. Zoom Communication (P.) Ltd* 327 ITR 510 (Del.), the assessee claimed deduction in respect of expenditure which was otherwise not allowable under the law. The claim was disallowed and penalty was also levied u/s. 271. The Hon'ble Court confirmed the penalty in view of deeming provisions of Explanation-1 since assessee could not prove the bona fide of such claim.

Where a wrong claim was made in respect of carried forward of losses though on facts there was no such loss, it was held to be a case of concealment of particulars and penalty was leviable. [*U.P. Matsya Vikas Nigam Ltd. vs. CIT* 232 Taxman 476(All);

It is not necessary to discuss all cases since it will depend on facts of each case whether the claim made was bona fide or not. If the mala fide of claim is apparent then penalty can be sustained.

In my view, a distinction has to be made between cases where all material facts are duly declared in the return but a bona fide claim has been made for exemption or deduction of any expenditure or allowance AND cases where such claim is made without any basis on facts and law. **Explanation 1** itself makes it clear that assessee must offer an explanation in support of his claim to prove his bona fide. Mere rejection of explanation without any basis is not sufficient for imposing the penalty. Before imposing the penalty, the AO must prove that such explanation is either false or the assessee had failed to substantiate the explanation and prove his bona fide of the explanation and failed to disclose all necessary facts material to computation of income. In case of failure on his part, the levy of penalty cannot be sustained. However, if no explanation is offered

regarding facts by assessee then, penalty would be justified as per the deeming provisions.

Whether penalty can be levied in case of surrender by assessee?

In order to appreciate this issue, it would be relevant to understand as to what point of time the concealment of particulars of income or furnishing of inaccurate particulars of income takes place and secondly which provisions would apply i.e., prevailing in the relevant assessment year or the year in which default was committed. This aspect of the matter has been adjudicated by the Hon'ble Apex Court in the case of *Brij Mohan* 120 ITR 1 SC wherein it was held as under —

"The penalty is, however, imposed on account of the commission of a wrongful act, and would be determined by law operating on the date on which such wrongful act is committed. Where penalty is imposed for concealment of particulars of income, it is the law ruling on the date when the act of concealment takes place, which is relevant. It is wholly immaterial that the income concealed was to be assessed in relation to an assessment year in the past.

The concealment of the particulars of his income was effected by the assessee when he filed a return of total income on 24-4-1968. Accordingly, it is the substituted clause (iii), brought in by the Finance Act, 1968, which governs the case. That clause came into effect from 1-4-1968".

In its subsequent decision in the case of *Onkar Saran & Sons* 195 ITR 1 SC, the Court followed the above decision and further laid down that wrongful act is committed when original return is filed and not when return is filed u/s. 148. Similar observations have been made in *CIT vs. Reliance Petroproducts (P.) Ltd.* 322 ITR 158 SC. These decisions lay down the law that wrongful act is committed when the original return is filed.

Surrender in the course of survey?

It is submitted that the **surrender** of the income may be in various situations i.e., (i) in the course of survey for the current financial year, (ii) in the course of survey for the preceding financial year(s) for which return has not been filed, (iii) in the course of survey for the financial year in respect of which return has already been filed, (iv) in the course of assessment proceedings, (v) surrender is made in the return filed u/s. 139(5) or 148. Considering the aforesaid decisions of the Apex Court, **in my opinion**, the answer would be as follows---

- In situation (i), the return is yet to be filed after the close of the year in respect of which surrender was made. Therefore, if the surrendered amount is disclosed in the return filed for such year, the question of concealment does not arise. Hence, no penalty can be levied in such cases. This legal position would also apply to situation (ii) also. [*CIT vs. SAS Pharmaceuticals* 355 ITR 259 (Del.); *Vasavi Shelters vs. ITO* 141 ITD 590 Bang.];
- However, in situations (iii), (iv) & (v), penalty can be legally imposed in the absence of any explanation by assessee in terms of *Explanation 1* to section 271(1)(c) since wrongful act was committed when original return was filed and subsequent return either u/s. 139(5)/148 would not absolve the assessee from levy of penalty. [*CIT vs. Mak Data* 358 ITR 593 SC; *Grass Field Farms & Resorts (P.) Ltd. vs. DCIT* 388 ITR 395 (Raj.) *Shveta Nanda vs. CIT* 336 ITR 298 (PH); *R. Padmanabhan vs. DCIT* 371 ITR 211 Mad.]

Surrender in course of search proceedings?

At the outset, it may be mentioned that **Explanation 5** was inserted in section 271(1)© w.e.f 1-10-1984 which deals with search cases and its application is restricted to search initiated before 1-6-2007. Explanation 5A has been inserted

by Finance Act, 2007 and is applicable to cases where search is initiated on or after 1-6-2007 and then substituted with retrospective effect from 1-6-2007 by Finance (No 2) Act, 2009. At this stage, it is pointed out that discussion is being restricted to surrender of income by assessee as a result of search and not on the scope of these *Explanations*.

Explanation 5 provides deemed concealment of particulars of income or furnishing of inaccurate particulars in respect undisclosed assets **unless the assessee declares in the statement made u/s. 132(4) to the effect that such assets have been acquired out of the income which has not been disclosed so far and also specifies the manner in which such income has been derived and pays the tax together with interest**.

The important aspect to be kept in mind is that principle stated by the Hon'ble Apex Court in case of Brij Mohan as well as in Onkar Saran & Sons would not be applicable and income in respect of undisclosed assets shall, by legal fiction, be considered as income in respect of which particulars are concealed or inaccurate particulars are filed even though no return is filed by the assessee unless conditions specified are fulfilled. All the courts have held that immunity is available where all the conditions are satisfied. However immunity would not be available even if any of the conditions specified is not fulfilled. *CIT vs. S. D. V Chandru* [2004] 266 ITR 175 (Mad.), *Gebilal Kanhaialal (HUF) vs. Asstt. CIT* [2004] 270 ITR 523 (Raj.), *CIT vs. Amardeep* 216 Taxman 63 (Cal.)

However, some litigation has arisen in certain cases which are discussed below:

In case of *CIT vs. Gebilal Kanhaialal HUF* 348 ITR 561 SC, the Court held that no time limit for payment of such tax stood prescribed under exception (2). The only requirement stipulated in the third condition was for the assessee to "pay tax together with interest". Since the tax along with interest was paid before completion of assessment, the condition stood satisfied and penalty could not be imposed.

In some cases, question arose whether penalty could be levied where the income is surrendered u/s. 132(4) and the same is declared in the return filed u/s. 153A on the ground that concealment took place when the original return was filed. In case of *Neeraj Jindal 393 ITR 1 (Del.)* the Court held that as per the provisions of section 153A, the earlier return filed u/s. 139 stands abated and becomes non est. The return filed u/s. 153A alone is to be taken into consideration. Hence, appeal of revenue was dismissed. Similar view has been taken by *Hon'ble Gujarat HC in Kirit Dahyabhai Patel vs. ACIT [2017] 80 taxmann.com 162.*

In case of *CIT vs. Meera Devi 212 Taxman 268 (Del.)*, it was held that such immunity cannot be availed by an assessee filing return u/s. 153C.

In case of *CIT vs. Abdul Rashid [2013] 40 taxmann.com 244 (Chhattisgarh)*, the question arose whether immunity could be denied where return was filed after the due date. The Court, following the decision of SC in Gebilal's case held that immunity could not be denied since Explanation 5 nowhere provides that in order to claim immunity, the return of income must be filed by the due date u/s 139.

In the case of *Sanjay Agarwal vs. CIT 211 Taxman 178 PH*, the court held that immunity is not available where the surrender was made u/s. 131 after the completion of search.

In the case of *Jawaharlal Jain HUF 370 ITR 712 (PH)*, the Court held that where statement recorded u/s. 132(4) was later on retracted and income surrendered was not included in the return, penalty levied was justified.

In the case of *PCIT vs. Jigesh Venilal Koralwala 387 ITR 177 Guj.*, it was held that penalty could not be levied in terms of explanation 5 unless, during search, assessee was found to be owner of any money, bullion, jewellery or other valuable article or thing.

In the case of *CIT vs. Mahendra C. Shah 299 ITR 305 Guj.*, it was held that it was the duty of the authorized officer to ask specific question regarding the requirement of Explanation 5 while

recording statement u/s. 132(4). The assessee is required to answer only the questions asked and nothing more. Hence, if no question was asked about the manner in which income was derived then the AO could not deny the immunity to the assessee if other conditions are satisfied. **Similar view** is taken by Hon'ble All HC in case of *CIT vs. Radha Kishan Goel 278 ITR 454 (All.)*.

However, recently, the Hon'ble **Delhi HC in the case of Ritu Singal vide judgment dated 12-3-2018**, did not agree with the of Hon'ble All HC in the case of **Radha Kishan Goel** (supra).

In the case of *Pradip Chandulal Patel 197 ITR 385 Guj.*, the assessee had stated in statement u/s. 132(4) that cash found represented income from betting which was disbelieved by AO and refused to provide immunity under Explanation 5 on the ground that assessee could not substantiate the same. The action of revenue was upheld by the Hon'ble High Court. However, in my view, the exception (2) in Explanation 5 does not compel the assessee to substantiate his statement. This is apparent from the legislative intent from the provisions of section 271AAA which provides that assessee not only has to specify the manner but must also substantiate the same in order to avail the immunity.

It will not be out of place to refer the decision of Hon'ble Cal. HC in case of *CIT vs. Prasana Dugar 371 ITR 19* wherein search was made on 3rd Feb. 2009 and the assessee surrendered income u/s. 132(4) in respect of A.Y. 2008-09. The penalty was levied u/s. 271(1)(c) which was deleted by the Tribunal. However, in appeal before the High Court, the levy of penalty was held to be justified on the ground that assessee had already filed the return for such year before search which resulted in concealment of income. It is interesting to note that counsel for the assessee had relied on clause (b) in *Explanation 5A* while the Hon'ble Court relied on clause (a). On the other hand the Tribunal recorded that no incriminating material was found in the course of search carried out 3rd February 2009. If no incriminating material was found in the course of search then Explanation

5A became inapplicable and therefore, penalty was leviable u/s. 271(1)(c) since return for A.Y. had been filed before the date of search. From the judgment, it appears that the counsel as well the Court proceeded on the basis that *Explanation 5A* was applicable. If the *Explanation 5A* was applicable then, in my humble opinion, the penal provisions of section 271AAA were attracted and penalty u/s. 271(1)(c) could not be levied in view of specific provisions of sub-section (3) of section 271AAA. However, on facts of the case, the *Explanation 5A* was not applicable since neither any money, bullion, jewellery, or other valuable article or thing nor any other incriminating material was found in course of search. Hence, section 271AAA could not be attracted. Thus, penalty was rightly sustained in view of the decision of the Apex Court in case of Brij Mohan (*supra*) as additional income was offered after filing of original return. It may also be noted that SLP filed by the assessee has been dismissed by the SC. The Hon'ble Delhi High Court has also sustained the penalty on similar facts in the case of Dr. Vandana Gupta delivered on 20-2-2018.

Whether penalty can be levied in loss cases?

The first case on this issue arose in case of **Prithipal Singh & Sons** before the Hon'ble Pb. & Hr. High Court. The Court held that where the returned loss was reduced on account of some addition and tax payable was still nil, question of penalty did not arise since penalty was leviable in addition to tax only as per the provisions of *Explanation 4*. If there was no tax payable, no penalty could be leviable. This decision was upheld by the Apex Court in 249 ITR 670 SC. In its subsequent judgment in *Virtual Soft Systems Ltd* 289 ITR 83 SC, it was held that earlier decision in Prithipal's case would continue to apply after insertion of *Explanation 4* to section 271(1)(c) with effect from 1-4-1976 by the Finance Act, 1975. However, this decision was overruled by the Apex Court in case of *Gold Coin Health Food (P.) Ltd* 304 ITR 308 by holding that the word 'income'

would include negative income also as held earlier by the Court in case of *Harprasad & Co.* 99 ITR 118 SC. This decision further held that it will apply w.r.e. from 1-4-1976.

However, *Explanation 4* was amended with retrospective effect from 1-4-2003. According to this *Explanation*, penalty became leviable with reference to tax that would have been chargeable on the income in respect of which particulars have been concealed or inaccurate particulars have been furnished even where the additions made had the effect of reducing losses declared by assessee. Thus, the **final view** is that penalty is leviable even where income returned by the assessee is loss.

Explanation 4 has again been substituted by Finance Act, 2015 w.e.f. 1-4-2016 which provides a formula for computing the penalty. No comments are needed on this aspect.

Quantum of penalty

1. It is not necessary to go into the history on this issue. Section 271 provides minimum penalty equal to the tax sought to be evaded and the maximum penalty goes up to three times of such tax. However, it would be relevant to refer the decision of the Hon'ble Apex Court in case of Brij Mohan vs. CIT 120 ITR 1 SC wherein it was held that infraction of law in such cases is committed when return of income is filed and therefore, the law prevailing on the date of original return is filed. In this case, the return for A.Y. 1964-65 was filed on 24-4-1968. The question arose whether penalty should be levied as per the law relating to the relevant assessment year or the law prevailing on the date of filing return. The Court held that act of concealment of particulars took place when the return was filed and therefore penalty should be levied as per the law prevailing on such date.
2. As per the main provisions of section 271(1)(c), as discussed earlier, the quantum of

penalty leviable varies between 100% to 300% of the tax payable depending upon the facts of the case. However, in case of search initiated on or after 1-10-1984, the legislature has provided for different treatment by inserting *Explanation 5 & Explanation 5A* which are being discussed hereafter. If the conditions specified therein are not fulfilled then penalty is leviable as per the normal provisions stated above.

It may be noted that a new section 271AAA was also inserted w.e.f. 1-4-2007 for levying penalty in cases where search is initiated on or after 1-6-2007 but before 1-7-2012. Another section 271AAB was inserted for levying penalty where search was initiated on or after 1-7-2012. The scope of these provisions are discussed below.

3. Now, it may be mentioned that in cases where search u/s. 132 was initiated on or after 1-10-1984 but before 1-6-2007 & provisions of Explanation 5 are attracted, no penalty u/s. 271 was leviable if the taxpayer complied with the conditions specified in the provisions of exception 2 in Explanation 5. If the conditions specified therein were not complied with then deeming provisions regarding concealment of particulars or furnishing of inaccurate particulars of income stood attracted and consequently, usual penalty as prescribed in section 271 was leviable. It may also be stated that immunity was available only in those cases where main provisions of such *Explanation* were attracted. For example, where no assets, as specified in this *Explanation*, were found in course of search then no benefit could be availed under this provision.
4. The above scheme was changed in respect of cases where search u/s. 132 was initiated on or after 1-6-2007 by inserting *Explanation 5A* and section 271AAA by Finance (No. 2) Act, 2009 with retrospective effect from 1-6-2007. In cases where provisions of

Explanation 5A stood attracted, the penalty @ 10% of the undisclosed income of specified year was leviable. These two terms have been defined in the *Explanation* attached to this section. Specified years are (i) the previous year in which search is conducted and (ii) the previous year which has ended before the date of search for which date of filing of the return u/s. 139(1) has not expired. Thus, it may be noted that this scheme is limited to either one year or maximum of two years depending upon the date of search. **For example**, where the search took place on 10-5-2009, the *specified previous years* would be F.Ys. 2008-09 & 2009-10. On the other hand, where search took place on 2-1-2010 then such year would be only F.Y. 2009-10 since due date for filing the return for F.Y. 2008-09 had expired before the date of search. However, if on facts, the case did not fall within the ambit of the provisions of Explanation 5A then usual penalty as per section was leviable.

However the above scheme is withdrawn and restricted to search initiated up to 30-6-2012.

5. In respect of searches initiated on or after 1-7-2012, a new section 271AAB was inserted by Finance Act 2012. It is in three parts. As per first part, penalty is to be levied @ 10% of undisclosed income if the conditions specified in clause (a) are satisfied. [These conditions are almost similar to section 271AAA(2)]. As per the second part, levy of penalty is @ 20% of the undisclosed income if the conditions specified in clause (b) are satisfied. As per this part, the assessee is not required to admit the undisclosed income in the course of search. If the assessee files the return of specified year disclosing the undisclosed income and pays the tax with interest, he can avail the benefit of concessional rate of 20%. The third part provides levy of

penalty @ 30% of undisclosed income if not covered by earlier 2 parts mentioned above. Where the conditions specified are not fulfilled then usual penalty u/s. 271 would be applicable.

6. It may be noted that section 271 is no more applicable from A.Y. 2017-18 as per sub-section (7) inserted by Finance Act 2016 w.e.f. 1-4-2017. From A.Y. 2017-18, the penalty is to be levied as per the new provisions of section 270A with which we are not concerned at this stage.

Whether penalty can be levied on legal heirs?

Legal heir comes into picture either when assessee dies before filing the return or where assessee dies after filing of the return or when assessee dies after completion of assessment proceedings. The liability of heir is restricted in terms of section 159 of the Act.

A bare reading of section 159 reveals that legal heir is personally liable to pay the tax and does not refer to penalty. Though sub-section (1) speaks of “any sum payable”, sub section (2) refers to the expression “for the purpose of making an assessment, reassessment or recomputation u/s. 147”. Hence, **in my view**, the liability of legal heirs does not extend to penalty imposable under the Act.

In the case of *CIT vs. Tikka Ram 174 Taxman 317 (PH)*, the assessee died after the issue of notice u/s. 148 and the return was filed by the legal heir. In the course of assessment she expressed her ignorance about the source of investment in property and filed revised return including the amount of such investment. Such return was accepted but the AO also levied penalty u/s. 271(1)(c). The Hon'ble Tribunal deleted the penalty considering the peculiar circumstance and *bona fide* on the part of legal heir. On appeal, the Hon'ble High Court confirmed the order.

In the case of *N. R. Palanivel vs. CIT232 Taxman 478 (Madras)*, the assessment u/s. 148 was completed after accepting revised return. Penalty proceedings u/s. 271(1)(c) were initiated. In the meanwhile, the assessee expired and the legal heir requested for dropping the penal proceedings. However, the penalty was levied. The matter travelled up to High Court. The Hon'ble Court noted that assessee was suffering from serious illness and had given some explanation regarding the source of investment and the legal heir also furnished explanation but the AO had not considered the same. Hence, the matter was restored to the file of AO for reconsideration.

There are some other decisions of High Court but the matter had been decided on merits with reference to section 271. In none of them, the liability u/s. 271 had been challenged with reference to section 159 of the Act. However, Hon'ble All HC in case of *Kalawati Devi vs. ITO 6 Taxman 252* decided the issue in favour of revenue.

However, my view is fortified by the various decisions of the Hon'ble Tribunal. Reference can be made to the decision in case of *ITO vs. V. P. Sharma 154 Taxman 34 (Del.)* wherein a very reasoned order has been passed by holding that proceeding against legal heir can be initiated only for the purposes of assessment or reassessment but not for the purpose of levy of penalty u/s. 271. Similar view has been taken by the Hon'ble Tribunal in case of *Srikishan Agarwal vs. DCIT [2017] 88 taxmann.com 380 (Jaipur)*; *Bhuban Mohan Mitter Charitable Trust vs. ITO 45 ITD 617 (at 622)*; and in case of *ACIT vs. Nageshwar Prasad 63 ITD 29 (Pat.)*.

This article has been prepared with the best of my efforts despite time constraint. The readers may modify the legal position if something is left to be deliberated.

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Rahul Hakani, Advocate

Penalty u/s. 271(1)(C) – Up to A.Y. 2016-17

I. Introduction

The provisions of Section 271(1) have been in the statute book for more than 56 years. Major legal issues have to a greater extent been settled. Yet due to almost automatic initiation and consequent levy of penalty had given rise to proliferation of litigation. In *CIT vs. Reliance Petro Products* 322 ITR 158 (SC) the Supreme Court stated:

“If we accept the contention of the revenue then in case of every return where the claim made is not accepted by the Assessing Officer for any reason, the assessee will invite penalty under Section 271(1)(c). That is clearly not the intendment of the legislature.”

From AY 2017-18 a new Section 270A under chapter XXI which provides for penalty on under-reporting of income and misreporting of income is introduced. According to the memorandum to the Finance Bill this amendment is done in-order to rationalize and bring objectivity, certainty and clarity in the penalty provisions.

However, the analysis of new section 270A indicates that there will be a number of issues on which both the assessee and revenue will be at loggerheads. In fact majority of those issues would be the ones which are settled u/s. 271(1).

Hence, it becomes very important for us to recapitulate analysis of Section 271(1) whenever we deal with issues u/s. 270A.

II. Nature of Penalty & Rules of Interpretation

Starting issue is whether penalty provisions u/s. 271(1)(c) entail a strict/civil liability or a criminal liability. Normally since the provisions are penal in character the association of criminality is normally attributed. However, it is now a law developed by Courts that the position of penal provision under the Act is more in the nature of civil liability rather than criminal liability. The Supreme Court in *Union of India vs. Dharmendra Textile Processors* [2008] 306 ITR 277 (SC) while considering the effect of penalty under section 271(1)(c) as well as Section 11AC of the Central Excise Act, 1944 has held that penalty in taxing statutes is to provide remedy for loss of revenue and is thus a civil liability. A penalty imposed for a tax delinquency is a civil obligation, remedial and coercive in its nature, and is far different from the penalty for a crime or a fine or forfeiture provided as punishment for the violation of criminal or penal laws. Thus, penalty provisions entail an absolute liability or strict liability for breach of statutory provisions and are not akin to criminal liability.

Though penalty provisions in taxing statutes are civil in nature, yet there is an element of coercion as held in *Gujarat Travancore Agency vs. CIT* [1989] 3 SCC 52 SCC (p. 55, para 4). Thus the Courts in India have reiterated time and again that the rule of strict construction applies to penal provisions. Thus, the penal provisions must be construed strictly [*CIT vs. Sundaram Iyengar & Sons (P) Ltd.* (1975) 101 ITR 764 (SC)]. The general thinking is that there must be some element of *mens rea* in order to attract penal provisions. This thinking is valid since instances of concealment or misreporting signal that there must be some intention to defraud the revenue. To say in simple terms, penalty can be levied only if all the ingredients of penal statute are strictly applicable and complied with before penalty is levied. However, it is also to be noted that in construing penal provisions strictly, the legislative intention cannot be ignored. For instance, in the case of *Virtual Soft Systems Ltd. vs. CIT* (2007) 289 ITR 83 (SC) by applying the principle of strict interpretation it was held that the 2002 amendment in *Explanation 4* to section 271 of the Income-tax Act permitting levy of penalty on loss to loss cases was prospective as it was consciously made effective from April 1, 2003. However the said decision was by the Larger Bench in *CIT vs. Gold Coin Health (P) Ltd.* (2008) 304 ITR 308 (SC) wherein it was held that said amendment was retrospective in view of the legislative intention. Thus a penal provision has to be construed strictly and narrowly and not widely but with the object of advancing the object and intention of the Legislature. Also, the penal provision giving benefit to an assessee such as section 273A has to be construed liberally. [*Handa (RP) vs. ITO* (1992) 198 ITR 54 (P & H)].

The Supreme Court in the case of *CIT vs. Vegetable Products Ltd.* (1973)88 ITR 192 (SC) has held as under:

“There is no doubt that the acceptance of one or the other interpretation sought to be placed on section 271(1)(a)(i) by the parties would lead to some inconvenient

result, but the duty of the Court is to read the section, understand its language and give effect to the same. If the language is plain, the fact that the consequence of giving effect to it may lead to some absurd result is not a factor to be taken into account in interpreting a provision. It is for the legislature to step in and remove the absurdity. On the other hand, if two reasonable constructions of a taxing provision are possible, that construction which favours the assessee must be adopted. This is a well-accepted rule of construction recognised by this Court in several of its decisions.”

Thus, where the two views interpretations are possible then the Court would adopt interpretation which is in favour of the taxpayer as laid down in *Pradip J. Mehta vs. CIT* (2008) 300 ITR 231 (SC). The Court will not interpret a statutory provision in such a manner that would create “additional fiscal burden” on the tax payer. Thus, where two views are possible or where there is an ambiguity in penal provisions, courts will lean in favour of the assessee.

III. Requirement of *mens rea* on the part of the assessee

The term *mens rea* deals with culpable mental state. It signifies element of deliberateness. Under section 271(1)(c) the ordinary meaning of “concealment” and “furnishing inaccurate particulars” contains an element of culpable mental state. The Apex Court in *Dilip N. Shroff vs. CIT* [(2007) 291 ITR 519 (SC)] held therein that in order to attract the penalty under Section 271(1)(c), *mens rea* was necessary, as according to the Court, the word “inaccurate” signified a deliberate act or omission on behalf of the assessee. The Court ultimately went on to hold that the element of *mens rea* was essential. However, subsequently it was on the point of *mens rea* that the judgment in *Dilip N. Shroff vs. CIT* [supra] was upset by the decision in *Union of India vs. Dharamendra Textile Processors* (2008) 306 ITR 277 (SC) after quoting from Section 271

extensively and also considering Section 271(1)(c), the Court came to the conclusion that since Section 271(1)(c) indicated the element of strict liability on the assessee for the concealment or for giving inaccurate particulars while filing return, there was no necessity of *mens rea*. The Court went on to hold that the objective behind the enactment of Section 271(1)(c) read with the *Explanations* indicated that the said section was for providing remedy for loss of revenue and such a penalty was a civil liability and, therefore, wilful concealment is not an essential ingredient for attracting civil liability as was the case in the matter of prosecution under Section 276-C of the Act.

However, though revenue doesn't have to prove *mens rea*, the element of deliberateness infused in the terms "concealment" and "inaccurate" will determine the issue of burden of proof.

IV. Burden of proof and how to discharge the burden of proof

One of the most important criteria in construction of penal provisions is to determine on whom the burden of proof lies. Also another aspect is when such burden of proof shifts.

Both the words "concealment" and "furnishing inaccurate particulars in the context of section 271(1)(c) indicate *prima facie* the intention of an assessee to hide his income or particulars thereof from the department. Consequently these words cast a burden on the department to prove the guilty mind as well as concealment. This legal position was confirmed by the Apex court in *CIT vs. Anwar Ali* (1970) 76 ITR 696 (SC) *Jain Brothers vs. UOI* (1970) 77 ITR 107 (SC), *Hindustan Steel Ltd vs. CIT* (1972) 83 ITR 26 (SC) and *CIT vs. Khoday Eswaras and Sons* (1972) 83 ITR 369 (SC).

To defeat this interpretation of law, Explanation 1 was introduced in section 271(1)(c). This explanation shifted the burden of proof from the Assessing Officer to the assessee. Instead of the AO being under an obligation to establish the *mala fides* of the assessee, the burden was now

on the assessee to establish his *bona fides* and innocence. The Pune Tribunal in *Kanbay Software India P. Ltd. vs. DCIT* [2009] 122 TTJ 721 (Pune) while dealing with the observation of Supreme Court in case of *Union of India vs. Dharamendra Textile Processors* [2008] 306 ITR 277 (SC) to the effect that penalty under section 271(1)(c) is to provide remedy for loss of revenue and is a civil liability held that judgment in Dharmendra Textile Processors case (*supra*) does not make a radical change in scheme of section 271(1)(c) but it re-emphasises paradigm shift of burden of proof as brought about by *Explanation* to section 271(1)(c). Thus, where the charge is of concealment of income and *Explanation 1* is invoked the initial burden is cast on the assessee.

Before analysing how an assessee can discharge the burden cast on him under S.271(1)(c) of the Income Tax Act, 1961, it is important to keep in mind the fundamental legal proposition that Assessment proceedings are not conclusive for levying penalty. Thus, assessment proceedings and penalty proceedings are separate and distinct. Findings in assessment proceedings don't operate as *res-judicata* in penalty proceedings. This proposition is laid down by the decision in *CIT vs. Dharamchand L. Shah* (1993) 204 ITR 462 (Bom.). Further, in *Vijay power Generators Ltd. vs ITO* (2008) 6 DTR 64 (Del.) it is held that

"It is well-settled that the findings rendered in the assessment proceedings though they constitute good evidence do not constitute conclusive evidence in penalty proceedings. During penalty proceedings, there has to be reappraisal of the very same material on the basis of which the addition was made and if further material is adduced by the assessee in the course of the penalty proceedings, it is all the more necessary that such further material should also be examined in an attempt to ascertain whether the assessee concealed his income or furnished inaccurate particulars thereof."

Thus, under penalty proceedings assessee can discharge his burden by relying on the same material on the basis of which assessment is made by contending that all necessary disclosures of material facts were made and that the explanation of assessee was *bona fide*. Further if there is any material or additional evidence which was not produced during assessment proceedings same can be produced in penalty proceedings as both assessment and penalty proceedings are distinct and separate.

V. Levy of penalty u/s. 271(1)(c) is not automatic

If penalty provisions are considered automatic it means that the moment default/breach is established or an addition is confirmed, penalty will be levied. There is no need of show cause notice. There are no specific ingredients to be fulfilled before levying of penalty. However, whether the penal provisions are automatic or not has to be construed from the language of the provision. The penal provisions in the context of Income-tax Act particularly Section 271(1)(c) are held to be not automatic. In fact, after the decision of Apex Court in *UOI vs. Dharmendra Textiles (Supra)* in the context of Section 271(1)(c) it was understood by the revenue authorities that penalty proceedings are automatic and that penalty is to be levied the moment addition is made or confirmed. This erroneous understanding was set at naught by the Apex Court in *Union of India vs. Rajasthan Spinning & Weaving Mill* (2009) 180 Taxmann 609 (SC) wherein it was held as under:

"At this stage, we need to examine the recent decision of this Court in Dharmendra Textile (*supra*). In almost every case relating to penalty, the decision is referred to on behalf of the Revenue as if it laid down that in every case of non-payment or short payment of duty the penalty clause would automatically get attracted and the authority had no

discretion in the matter. One of us (Aftab Alam, J.) was a party to the decision in Dharmendra Textile and we see no reason to understand or read that decision in that manner."

In *CIT vs. M/s Sidhartha Enterprises* (2009) 184 Taxman 460 (P & H)(HC) it was held that "the judgment in Dharmendra Textile cannot be read as laying down that in every case where particulars of income are inaccurate, penalty must follow. Even so, the concept of penalty has not undergone change by virtue of the said judgment. Penalty is imposed only when there is some element of deliberate default and not a mere mistake. In view of the finding that the furnishing of inaccurate particulars was simply a mistake and not a deliberate attempt to evade tax, penalty was not leviable."

Discretion cannot be arbitrary but must be as a result of judicial thinking. In levy of penalty, discretion and prudence are required to critically examine the situation and circumstances and the discretion is to be applied with caution. And of the essential thing required is to distinguish between falsity and truth and the same are required to be applied with rules of reason and justice. Finally, the discretion must be exercised in such a way that an honest man competent to discharge his duty would have done so as laid down in *S. G. Jaisinghania vs. UOI* AIR 1967 SC 1427.

In following cases where Quantum was confirmed by the Tribunal it was held that levy of penalty was not justified.

CIT vs. Petals Engineers P. Ltd. (2014) 223 Taxman 15 (Bom.)(HC)(Mag.)

CIT vs. S. M. Construction (2015) 233 Taxman 263 (Bom.)(HC).

Hence, penalty u/s. 271(1)(c) is not automatic but discretionary and that the assessing officer must exercise the discretion judicially. Thus, he can even drop penalty notice after considering the explanation of the assessee.

VI. Commencement of penalty proceedings, initiation of penalty proceedings, satisfaction for initiation for penalty proceedings and recording of such satisfaction

Section 271(1) reads “If the assessing officer or.....in the course of any proceedings under this Act, is satisfied that any person.....he may direct that such person shall pay by way of penalty” [emphasis supplied]

The Apex Court in *CIT vs. S.V. Angidi Chettiar* [1962] 44 ITR 739 (SC) has held that penalty proceedings cannot be commenced by the ITO before completion of the assessment proceedings by the ITO. However, the power to impose penalty depends upon the satisfaction of the ITO in the course of proceedings under the Act i.e., it could not be exercised if he is not satisfied about the existence of conditions for penalty before the proceedings are concluded. Satisfaction before conclusion of the proceeding under the Act, is a condition for the exercise of the jurisdiction.

Considering the said decision, the Bombay High Court in *CIT vs. Dajibhai Kanjibhai* [1991] 189 ITR 41 (Bom.) has held that AO must “record” his satisfaction during the course of assessment proceedings. The Full Bench of the Delhi High Court in *CIT vs. Rampur Engg Co. Ltd.* [2009] 309 ITR 143 (Delhi) has held that the

“Power to impose penalty under section 271(1) depends upon satisfaction of Assessing Officer in course of assessment proceedings and it cannot be exercised if he is not satisfied and has not recorded his satisfaction about existence of conditions specified in clauses (a), (b) and (c) of sub-section (1) of section 271 before proceedings are concluded.”

Hence, there has to be satisfaction, such satisfaction has to be recorded, recording must be before completion of assessment proceedings and penalty proceedings though initiated before completion of assessment proceedings they will

have to commence after passing of assessment order.

After taking note of the judicial pronouncements in this regard, the Legislature thought it fit to insert Section 271(1)(B), which reads as under:

“271(1)(B) : Where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under clause (c) of sub-section (1), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings under the said clause (c).”

The above provision came up for interpretation before the Delhi High Court in the case of *Ms. Madhushree Gupta vs. Union of India* [2009] 309 ITR 143 (Del.) wherein the Delhi High Court held that both in post amendment and pre amendment there is not much difference and the satisfaction is required to be arrived in the course of assessment proceedings and should be discernible in the assessment order.

The Karnataka High Court in *CIT vs. Manjunath Cotton and Ginning Factory* [2013] 359 ITR 565 (Kar.) (HC) interpreted the term “Direction” and held as under:

“Use of the phrases like (a) penalty proceedings are being initiated separately and (b) penalty proceedings under Section 271(1)(c) are initiated separately, do not comply with the meaning of the word direction as contemplated even in the amended provisions of law. The direction should be clear and without any ambiguity. The word 'direction' has been interpreted by the decision of the Apex Court in the case of *Rajendranath* 120 ITR pg.14, where it has been held that in any event whatever else it may amount to, on its very terms the observation that the ITO

is free to take action, to assess the excess in the hands of the co-owners cannot be described as a direction. A direction by a statutory authority is in the nature of an order requiring positive compliance. When it is left to the option and discretion of the ITO whether or not take action, it cannot be described as a direction.”

Following the above ratio, in *CIT vs. MWP Ltd.* [2014] 264 CTR 502 (Karn.) (HC) wherein in the assessment order it was recorded “Penalty u/s. 271(1)(c) initiated separately.”, penalty was deleted. Thus there has to be a satisfaction and direction to initiate penalty should be clear, unambiguous and akin to an order requiring positive compliance.

VII. Penalty on surrendered income

There may be cases where assessee agrees to an addition during assessment proceedings, or during survey or during reassessment proceedings or does not prefer an appeal. An issue arises whether in such situation penalty u/s. 271(1)(c) would be automatic particularly in view of deeming fiction u/s. Explanation 1 to Section 271(1)(c).

In *Sir Shadilal Sugar and General Mills Ltd. vs. CIT* (1987) 168 ITR 705 (SC) it was held that from agreeing to additions, it does not follow that the amount agreed to be added was concealed income.

The Apex Court in the case of *K. P. Madhusudan vs. CIT* (2001) 251 ITR 99 (SC) has held that decision in *Shadilal's* case (Supra) is no more good law after insertion of Expl-1. After the decision in the case of *K. P. Madhusudan*, it was noticed that just because the assessee has agreed for the addition, the penalties were levied u/s. 271(1)(c).

It is to be stated that the above decision in the case of *K. P. Madhusudan* is not to be interpreted as meaning that in an agreed addition, penalty would automatically follow. It simply holds that under the Explanation 1, the

assessee should show that his failure to return correct income was not due to fraud or neglect. No separate enquiry is necessary for imposing penalty but the assessee is at liberty to show his bonafides in the penalty proceedings and if he does, no penalty can be imposed.

This decision of Supreme Court had been considered and analysed in the following decisions.

- i. *ITO vs. Smt. Devibai Parmani* [84 ITD 342]
- ii. *Dy. Director of Income Tax vs. Chirag Metal Rolling Mills Ltd.* [305 ITR 29 (MP)]
- iii. *CIT vs. P. Govindswamy* [263 ITR 509]

In fact, In *CIT vs. Suresh Chandra Mittal* (2000) 241 ITR 124 (M.P.) after considering Explanation 1 it was held that the revenue did not at all discharge the burden to prove that there was concealment of income by the assessee. It simply rested its conclusion on the act of voluntary surrender by the assessee, which obviously was done in good faith and to buy peace.

The above decision is upheld by the Supreme Court in *CIT vs. Suresh Chandra Mittal* (2001) 251 ITR 9 (SC). Thus it can be fairly concluded that once assessee gives a *bona fide* explanation for agreeing to addition then the burden shifts on the revenue to prove concealment. This position is further fortified by the Apex Court in *MAK Data P. Ltd. vs. CIT* (2013) 358 ITR 593 (SC) wherein it is held as under:

“Explanation to Section 271(1) raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the revenue to show that the amount in question constituted the income and not otherwise.”

In *CIT vs. Shri Hiralal Doshi* [2016] 383 ITR 19 (Bom.)(HC) confirming decision of ITAT in *ACIT vs. Shri Hiralal Doshi I.T.A. No. 6212/Mum/2010 (Mum.)(Trib.)* wherein after considering Supreme Court decision in *MAK Data (P) Ltd. vs. CIT (2013) 358 ITR 593(SC)* it is held that said decision is not universally applicable and penalty on income surrendered during survey was deleted.

It may also be noted where declaration is made during survey and the due date of return has not expired and declared amount is offered for tax then there can be no penalty u/s. 271(1)(c) read with Explanation 1 as held in following decisions:

- i) *Shri Dilip M. Shah Mumbai vs. ACIT ITA 4413/Bom/98 A.Y. 1994-95 dt. 25-1-1999*
- ii) *CIT vs. SAS Pharmaceuticals (2011) 335 ITR 259 (Del.)(HC)*
- iii) *ACIT vs. Crescent Property Developers ITA No. 2770/M/2012, dt. 19-6-2014*

However, Delhi High Court in *Pr. CIT vs. Dr. Vandana Gupta* has held that voluntary surrender of income after survey by filing a revised income does not save the assessee from levy of penalty for concealment of income in the original return if there is no explanation as to the nature of income or its source.

In *Vipul Life Sciences Ltd. vs. DCIT* [2015] 57 taxmann.com 25 (Mumbai - Trib.)/[2015] 68 SOT 321 (Mumbai - Trib.)(URO) consequent to survey, assessee offered additional amount and included it in its return in response to notice under Section 148. There being difference in amount as declared in original return and as filed in response to notice under Section 148, Assessing Officer initiated penalty proceedings and levied penalty. Penalty on surrendered income was deleted. In *Pankaj Kumar Gupta vs. ITO ITA 486/LKW/2016 dtd. 16-1-2018 (Luck) (Trib.)* it was held that though capital gains were not disclosed in the return, if tax on the same is paid after the s. 147 assessment order is passed, there is no loss

to the revenue and it also shows the *bona fides* of the assessee and penalty cannot be levied. The fact that if the s. 148 notice was not issued, the assessee would have got away with tax evasion does not mean that his action was not *bona fide*

VIII. Notice does not specify under which limb of Section 271(1)(c) penalty is initiated

In *CIT vs. Manjunatha Cotton & Ginning Factory (2013) 359 ITR 565 (Karn.)(HC)* (Para 63 (P & R)) it is held that Notice u/s. 274 should specifically state the grounds mentioned in s. 271(1)(c), i.e., whether it is for concealment of income or for furnishing of incorrect particulars of income. The assessee should know the grounds which he has to meet specifically. Otherwise, a principle of natural justice is offended. On the basis of such no penalty could be imposed to the assessee. In *CIT vs. SSA's Emerald Meadows* [2016] 73 taxmann.com 241 (Kar.) High Court affirmed decision of Tribunal, relying on decision of Manjunatha (Supra), holding that notice issued by Assessing Officer under section 274 read with section 271(1)(c) was bad in law, as it did not specify under which limb of section 271(1)(c) penalty proceedings had been initiated, i.e., whether for concealment of particulars of income or furnishing of inaccurate particulars of income. SLP against said order of High Court is dismissed in *Commissioner of Income-tax vs. SSA'S Emerald Meadows* [2016] 73 taxmann.com 248 (SC). Also, in the case of *CIT vs. Manjunath (Supra)* one of the appeals disposed off was *Veerabhadrapa Sangappa & Co. ITA No. 5020 of 2009* where the issue involved was identical. SLP against said appeal was dismissed.

Often the revenue cites the decision of Bombay High Court in *CIT vs. Smt. Kaushalya* [1995] 216 ITR 660 (Bom)(HC) and *Maharaj Garage & Company vs. CIT ITR No. 21 of 2008 dtd. 22-8-2017(Bom.)(HC)* for the proposition that even though the penalty notice does not specify whether penalty is levied for furnishing inaccurate particulars of income or concealment

of income and it did not cancel the irrelevant portion, the penalty notice is good in law.

In following cases, penalty has been deleted for non-striking irrelevant portion in the notice after considering above decisions and Bombay High Court decision in *CIT vs. Smt. Kaushalya (Supra)*.

- *Meherjee Cassinath Holdings vs. ACIT ITA No. 2555/M/2012, A.Y. 2008-09, dt. 28-4-2017 (Mum.)(Trib.)*
- *Smt Vijayaben Kanji Ashra vs. DCIT ITA NO 2254/M/2016, AY 2008-09 dt. 21-6-2017 (Mum)(Trib.)*
- *Uttam Value Steels Ltd. vs. ACIT ITA No. 3622/M/2016, A.Ys. 2010-11 dt. 22-5-2017(Mum.)(Trib.)*

In following cases, penalty has been deleted for non-striking irrelevant portion in the notice after considering above decisions and Bombay High Court decision in *Maharaja Garage & Company vs. CIT (Supra)*.

- *Mrs. Indrani Sunil Pillai vs. ACIT ITA No.1339/Mum./2016 dtd. 19-1-2018 (Mum.)(Trib.)*
- *Jeetmal Choraria vs. ACIT I.T.A No.956/Kol/2016 dtd. 1-12-2017(Kol.)(Trib.)*
- *Aditya Chemicals Ltd. vs. ITO ITA No. 5006/DEL/2013 dtd 21-11-2017 (Del.)(Trib.)*

IX. Penalty cannot be levied on both charges

Penalty cannot be levied for both the charges i.e., concealment of income as well as furnishing inaccurate particulars of income. In following cases it was held that fixing the twin charges is not permitted under the law.

- *CIT vs. Samson Perinchery ITA No. 1154 of 2014 dtd. 5-1-2017 (Bom.)(HC)*
- *Jehangir HC Jehangir vs. ACIT ITA No. 1261/M2011, A.Y. 2006-07 dt. 17-5-2017 (Mum.)(Trib.)*

- *Mangalam Drugs & Organics Ltd. vs. DCIT ITA No. 5454/M/2011 A.Y. 2004-05 dtd. 24-9-2015 (Mum.)(Trib.)*

X. Penalty on wrong legal claim, debatable issue etc.

The Supreme Court in *CIT vs. Reliance Petro-products Ltd. (2010) 322 ITR 158 (SC)* has held that merely because a legal claim of the appellant was not accepted in quantum proceedings, penalty cannot be imposed. Rejection of a wrong legal claim does not tantamount to furnishing inaccurate particulars of income.

In following cases it has been held that no penalty u/s. 271(1)(c) can be levied when two views are possible or where the issue is a debatable one:

- *Durga Kamal Rice Mills vs. CIT (2004) 265 ITR 25 (Bom.)*
- *CIT vs. Harshvardhan Chemicals & Minerals Ltd. [2003] 259 ITR 212 (Raj.)*
- *CIT vs. Ram Singhani Dall Mills [2002] 254 ITR 264 (MP)*
- *Chandrapal Bagga vs. ITAT [2003] 261 ITR 67 (Raj.)*
- *CIT vs. Calcutta Credit Corporation (1987) 166 ITR 29 (Bom.)*

XI. Penalty in case of all bona fide disclosures

The Hon'ble Bombay High Court in the case of *CIT vs. Dalmia Dyechem Industries Ltd. [2015] 377 ITR 133 (Bom.) (HC)* ruled that the Assessing Officer must render a conclusive finding that there was an active concealment or deliberate furnishing of inaccurate particulars and if the interpretation placed by assessee on the provisions of law while taking the actions in question, cannot be considered dishonest, *mala fide* and amounting to concealment of fact, no penalty can be levied. In *CIT vs. Nalin P. Shah (HUF) [2013] 40 taxmann.com 86 (Bom.) (HC)* the

Hon'ble Jurisdictional High Court held that as all details were disclosed in its return of Income, penalty cannot be levied.

In following decision, after considering the decision of Delhi High Court in *CIT vs. Zoom Communication (2010) 327 ITR 510*, penalty u/s. 271(1)(c) is deleted on the grounds that wrong claim of assessee if made *bona fide* and all relevant facts are disclosed.

- (i) *CIT vs. Societex (2012) 82 CCH 69 / (2013) 212 Taxman 73 (Mag.) / 259 CTR 325 / 87 DTR 373 (Delhi)(HC)*
- (ii) *Karan Raghav Exports P. Ltd. vs. CIT (2012) 349 ITR 112 (Del.)*
- (iii) *CIT vs. S. M. Construction (2015) 60 taxmann.com 135(Bom.)(HC)*

XII. Can penalty be levied on estimated addition in case of addition of bogus purchases etc.

In *CIT vs. Sonal Construction Co. (2015) 55 taxmann.com 425 (Guj.)(HC)* it was held that where addition was made on account of non-existing liabilities which was accepted by assessee only to avoid litigation, penalty imposed solely on basis of said addition overlooking details and explanation filed by assessee could not be sustained. In *Anita Builders vs. ACIT (2002) 74 TTJ 364 (Jod.) (Trib.)* it is held that merely because failure to produce parties or alleged bogus parties penalty cannot be levied. In *Earthmoving Equipment Service Corporation vs. DCIT (ITAT Mumbai) penalty u/s. 271(1)(c) was deleted by holding that the fact that the sellers are not traceable and the assessee surrendered the bogus purchases does not justify levy of penalty.* In *Pr. CIT vs. Fortune Technocomps (P) Ltd. ITA No 313/2016 dtd 13-5-2016 (Del.)(HC)* in quantum proceedings ITAT confirmed order of learned CIT(A) not confirming addition of entire bogus purchases but only profit embedded in bogus purchases. Penalty u/s. 271(1)(c) was deleted.

In following cases it has been held that no penalty can be levied on estimated additions as it does not tantamount to concealment of income or furnishing inaccurate particulars of income:

- *Harigopal Singh vs. CIT (2002) 258 ITR 85 (P & H)*
- *CIT vs. Rahamat Khan Birbal Khan Badruddin & Party (1999) 240 ITR 778 (Raj.)*
- *CIT vs. M.M. Rice Mills (2002) 253 ITR 17 (P & H)*
- *Sudarshan Silk vs. CIT (2008) 300 ITR 205 (SC)*

XIII. Penalty on additions under deeming provisions such as Section 50C etc.

In *CIT vs. Madan Theatres (2013) 260 CTR 75 (Cal.) (HC)* assessee had sold the property at ₹ 2,51,50,000/- and computed capital gains in its computation of income by taking sale consideration at ₹ 2,51,50,000/-. The Assessing Officer fixed the sale price at Stamp duty value of ₹ 5,19,77,000/- u/s. 50C and initiated penalty proceedings u/s. 271(1)(c). Assessee chose not to contest the stamp duty value u/s. 50C(2) as there was difference in the tax liability. Before the High Court it was argued by the revenue that as assessee did not dispute the stamp valuation before the assessing officer, penalty is leviable u/s. 271(1)(c). The High Court held that revenue failed to produce an iota of evidence to show that assessee actually received one paisa more than the amount shown to have been received by him and that the proceedings u/s. 271(1)(c) started only on the basis of deemed consideration. Thus, the High Court confirmed the order of the Hon'ble ITAT which had deleted the penalty u/s. 271(1)(c).

In *Shri Chimanlal Manilal Patel vs. ACIT ITA No. 508/Ahd/2010 dated 22/6/2012 (ITAT – Ahmedbad)* assessee in response to notice u/s. 148, filed revised return offering sales consideration on sale of land as per the provisions of S. 50C.

A.O. initiated penalty proceedings u/s. 271(1)(c) on the ground that assessee had not shown capital gains as per provisions of S. 50C in the original return of income. The Hon'ble ITAT held that A.O. had not disputed the consideration received by the assessee and had not doubted the genuineness of documents/details furnished by the assessee. Assessee agreeing to addition on the basis of deemed provisions cannot be construed as filing of inaccurate particulars of income. Accordingly penalty was deleted. In *Renu Hingorani vs. ACIT ITA No. 2210/M/2010 dated (ITAT-Mumbai)*, assessee had agreed to stamp duty valuation u/s. 50C during assessment proceedings. A.O. consequently initiated penalty u/s. 271(1)(c). The Hon'ble ITAT held that A.O. had not questioned the actual sale consideration and addition was made only on the basis of deeming provision of the Income-tax Act. Consequently, penalty levied u/s. 271(1)(c) was deleted by the Hon'ble ITAT. Similarly, penalty u/s. 271(1)(c) on additions u/s. 50C agreed by the assessee are deleted by the Chennai Bench of the Tribunal in *ACIT vs. Mrs. N. Meenakshi (2009) 125 TTJ (Chennai) 856* and Jodhpur Bench of the Tribunal in *Prakashchand Nahar vs. ITO (2007) 110 TTJ (Jd.) 886*.

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

In *Smt. Shantidevi Mahavir Prasad Gupta vs. ITO (2014) 151 ITD 445 (Mum)(Trib.)* penalty

u/s. 271(1)(c) was confirmed on addition u/s. 2(22)(e). In *Sunil chandra Vohra vs. ACIT (2009) 32 SOT 365(Mum.)(Trib.)* penalty u/s. 271(1)(c) was deleted on addition u/s. 2(22)(e). In *Smt Vijayaben Kanji Ashra vs. DCIT ITA No. 2254/M/2016, AY 2008-09 dt 21-6-2017 (Mum.)(Trib)* penalty on addition of deemed LOP as income from house property was deleted.

XIV. Penalty cannot be levied in case of inadvertent error or bona fide mistake

The Supreme Court in *PriceWaterhouseCoopers Pvt. Ltd vs. CIT (2012) 348 ITR 306 (SC)* has held that penalty cannot be levied u/s. 271(1)(c) for a "bona fide mistake, inadvertent mistake, human error. In *CIT vs. Bennett Coleman & Co. Ltd. (2013) 259 ITR 383 (Bom.)* and in *CIT vs. Somany Evergreen Knits Ltd. (2013) 352 ITR 592 (Bom.)* penalty u/s. 271(1)(c) was deleted on account of bona fide mistake.

XV. Can penalty be levied if issue is admitted by the High Court u/s. 260A.

The Bombay High court in *CIT vs. Nayan Builders P. Ltd. [2014] 368 ITR 722 (Bom.)(HC)* has held that where High Court admitted substantial question of law in respect of which penalty was levied, impugned order of penalty was to be deleted. However, the Bombay High Court in *Pr. CIT vs. Shree Gopal Housing & Plantation Corporation (Bom.)(HC)* has clarified its decision in *CIT vs. Nayan Builders (Supra)* and held that the law in *Nayan Builders* does not mean as a matter of rule that in case where the High Court admits an appeal relating to quantum proceedings *ipso facto* i.e. without anything more, the penalty order gets vitiated. The question of entertaining an appeal from an order imposing / deleting penalty would have to be decided on a case to case basis. There can be no universal rule to the effect that no penalty can be levied if quantum appeal is admitted on a substantial question of law. The High Court held as under :

“4. We find that the decision of this Court in *Nayan Builders (supra)* upholding the order of the Tribunal proceeded on the basis that no case was made out for imposition of penalty and the same was rightly set aside by the Tribunal. Further, the order of the Tribunal against which the above appeal in *Nayan Builders (supra)* was filed by the Revenue, clearly records the fact that the issues which arose in the quantum proceedings related to a *bona fide* claim of deduction under the Act. Further, the Tribunal held that the disallowance of claim of deduction which has been made *bona fide* would not by itself lead to penalty. Therefore, each appeal in respect of the order deleting / imposing a penalty by the Tribunal would have to be considered in relation to the facts arising therein and also in the quantum proceedings. It cannot be said as a matter of rule that in case where this Court admits an appeal relating to quantum proceedings *ipso facto* i.e. without anything more, the penalty order get vitiated. Thus, the question of entertaining an appeal from an order imposing / deleting penalty would have to be decided on a case-to-case basis. There can be no universal rule to the effect that no penalty, if quantum appeal is admitted on a substantial question of law.

5. In fact, the admission of an appeal in quantum proceedings, if arising on a pure interpretation of law or on a claim for deduction in respect of which full disclosure has been made, may, give rise to a possible view, that admission of appeal in the quantum proceedings would suggest no penalty can be imposed as it is a debatable issue. However, it cannot be a universal rule that once an appeal from the order of the Tribunal has been admitted in the quantum proceedings, then, *ipso facto* the issue is a debatable issue warranting deletion of penalty by the Tribunal. There could be cases where the finding of the Tribunal in quantum proceedings deleting addition could be perverse, then, in such cases, the admission of appeal in quantum proceedings would indicate that an appeal against deletion of penalty on the above account will also warrant admission.”

XVI. Can jurisdictional issue be raised for first time in penalty proceedings eg. 148/263 etc.

In *Tidewater Marine International Inc. vs. Dy. CIT (2005) 96 ITD 406 (Del.) (Trib.)* it was held that jurisdiction of reassessment proceedings can be challenged in penalty proceedings, though not challenged in the quantum proceedings.

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Each thought is a little hammer blow on the lump of iron which our bodies are, manufacturing out of it what we want it to be. We are what our thoughts have made us; so take care of what you think.

— *Swami Vivekananda*



CA Reepal G. Tralshawala

Penalty Consequent to Search Proceedings – Sections 271AAA/271AAB

Introduction

Legislature has intentionally differentiated in the Income-tax Act, 1961 penalties relating to and/or arising out of assessment / reassessment, etc. u/s. 271(1)(c) / u/s. 270A w.e.f. AY 2017-18 AND penalty relating to search and seizure action conducted u/s. 132 of the Act in terms of sections 271AAA / 271AAB [both read with Explanation 5A to sec. 271(1)(c)]. A search & seizure action is generally conducted for unearthing of undisclosed income and therefore stringent provisions are incorporated in the Act so as to have a deterrent effect on the public at large to disclose their true and correct income in the return of income filed.

The Legislature has amended the provisions relating to search and seizure action u/s. 132 of the Act keeping in mind that the provisions relating to penalty should not deter a honest tax payer from filing correct return of income. It is due to this reason that no 100% immunity from penalty is now allowed to a person who is searched and undisclosed income is unearthed.

At present, the penalty provisions existing in Income-tax Act relating to search and seizure action carried out u/s. 132 of the Act are summarised as under –

Section	Applicability
271AAA	Applicable for search initiated on or after 1-6-2007 but before 1-7-2012 AND for specified previous years
271AAB(1)	Applicable for search initiated on or after 1-7-2012 but before 15-12-2016 AND for specified previous years
271AAB(1A)	Applicable for search initiated on or after 15-12-2016 AND for specified previous years
Explanation 5A to sec.271(1)(c)	Applicable to search initiated on or after 1-6-2007 and for the years other than specified previous years defined in sec. 271AAA / 271AAB (1) / (1A)

Conditions and applicability of penal provisions u/s. 271AAA & 271AAB is summarised as under –

Conditions & Applicability	Sections		
	271AAA	271AAB(1)	271AAB(1A)
Applicable to Search initiated u/s. 132	Between 1-6-2007 & 30-6-2012	Between 1-7-2012 & 14-12-2016	On or after 15-12-2016
Penalty levied @ rate of –	10% of undisclosed income of specified previous year subject to immunity provision	Minimum 10% and maximum 90% [max. 60% w.e.f. 1-4-2017] of specified previous year	Minimum 30% and maximum 60% of specified previous year
Immunity from penalty provided	Fully	Partially	Partially
Condition for immunity/rate of penalty -			
a) In statement recorded u/s.132(4), undisclosed income admitted, specifies manner & substantiates manner of earning undisclosed income & pays tax together with interest in respect of undisclosed income	100% immunity	Penalty levied at 10% with a d d i t i o n a l condition of filing return of income on or before due date u/s. 139(1) declaring such u n d i s c l o s e d income	Penalty levied at 30% with a d d i t i o n a l condition of filing return of income on or before due date u/s. 139(1) declaring such u n d i s c l o s e d income
b) If condition of manner of earning undisclosed income and substantiation of same not fulfilled, then -	No immunity – penalty @10% of undisclosed income	Penalty levied at 20% as against 10% stated in (a) above	Penalty levied at 60% as against 30% stated in (a) above
c) If none of the conditions specified in above clauses (a) or (b) fulfilled, then –	No immunity – penalty @10% of undisclosed income	Penalty levied between 30% and 90% of u n d i s c l o s e d income – up to 31-3-2017 AND 60% from 1-4-2017	Penalty levied at 60% of u n d i s c l o s e d income
Definition given:			
Specified previous year means –	(i) Previous year ending before date of search and due date of filing return of income u/s. 139(1) has not expired before date of search and no return of income is filed till date of search; OR (ii) Year of search		

Conditions & Applicability	Sections		
	271AAA	271AAB(1)	271AAB(1A)
Specified date	Not defined and not applicable since filing return within due date u/s. 139 not mandatory to get immunity	Return to be filed within due date provided u/s. 139(1) or date specified in notice u/s. 153A for filing return, as the case may be	Return to be filed within due date provided u/s. 139(1) or date specified in notice u/s. 153A for filing return, as the case may be
Undisclosed income-	(i) any income of the specified previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account or other documents or transactions found in the course of a search under section 132, which has— (A) not been recorded on or before the date of search in the books of account or other documents maintained in the normal course relating to such previous year; or (B) otherwise not been disclosed to the Chief Commissioner/Commissioner before the date of search; or (ii) any income of the specified previous year represented, either wholly or partly, by any entry in respect of an expense recorded in the books of account or other documents maintained in the normal course relating to the specified previous year which is found to be false and would not have been found to be so had the search not been conducted		
Penalty u/s. 271(1)(c)/270A – whether can be imposed	No penalty u/s. 271(1)(c) / 270A of the Act can be imposed for the specified previous years where penalty can be imposed and levied only via section 271AAA/271AAB. If penalty is levied u/s. 271(1)(c) of the Act for the specified previous years, the same is bad in law and liable to be quashed. Section 271AAA/271AAB and section 271(1)(c) have different concomitant scopes and are mandated to operate exclusively – this view is taken in:- i) <i>ACIT vs. Prakash Steelage Ltd.</i> [2015] 153 ITD 493 (Mum.) ii) <i>Dr. Naman A. Shastri vs. ACIT</i> [2015] 155 ITD 1003 (Ahd.) iii) <i>Sandeep Chandak vs. ACIT</i> [2017] 55 ITR (Trib.) 209 (Luck.) iv) <i>Gillco Developers & Builders P. Ltd. vs. DCIT</i> [2017] 189 TTJ 355 (Chd.)		

Explanation 5A to sec. 271(1)(c)

As seen from the summarized chart, the provisions of sec. 271AAA / 271AAB of the Act is applicable only for the specified years and which could at best maximum cover two years only i.e. the year of search and year immediate prior to the year of search if covered by definition of specified previous year. Thus, for years covered under search action other than the specified previous years as defined above in sections 271AAA / 271AAB, provisions of section 271(1)(c) read with Explanation 5A is applicable.

Explanation 5A to section 271(1)(c) of the Act was inserted w.e.f. 1-6-2007 and provides that –

Where undisclosed asset/income is found during the course of search initiated u/s. 132 on or after 1-6-2007 for any previous year which has ended before the date of search and, —

- (a) where the return of income for such previous year has been furnished before the said date but such income has not been declared therein; or
- (b) the due date for filing the return of income for such previous year has expired but the assessee has not filed the return,

then, notwithstanding that such income is declared by him in any return of income furnished on or after the date of search, he shall, for the purposes of imposition of a penalty u/s. 271(1)(c), be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income.

Analysis of above provisions and issues thereon

Explanation 5A to sec.271(1)(c) of the Act seeks to make stringent provision in respect of penalty in relation to a person searched. This is for twin reasons i.e. firstly as per this Explanation,

penalty in respect of undisclosed income found in search action whether offered in return of income filed after search or otherwise [for all the years covered in search action other than years falling in section 271AAA/271AAB] is mandatory and there is no scope whatsoever for escaping from the rigors of this provision [refer *Mrs. Sarita Kaur Manjeet Singh Chopra vs. ITO [2015] 174 TTJ 516 (Pune)*; *Shri Rajnish Vora vs. DCIT, ITA 516/Chd/2012, AY 2007-08, Bench 'B', order dated 31-10-2012*; . Secondly, the penalty under this Explanation is also levied in respect of income that is recorded in the books of account of the assessee in cases where the due date for filing the return of income has expired and no return of income is filed before the date of search action for that assessment year and the assessee is having positive taxable income. Thus, even though regular books of account are maintained and the entries are duly recorded in the books of account, the income would be deemed to have been concealed if the due date for furnishing the return of income has expired and no return of income is filed as on the date of initiation of search action. In other words, the assessee is required to file the return of income within the due date.

Here the only saving grace for the assessee is that Explanation 5A to sec. 271(1)(c) merely refers to due date for filing return of income and does not specify whether 139(1) or 139(4) due date. As the language is not clearly worded, the benefit of doubt is given to the assessee whereby due date in Explanation 5A has been interpreted in various judicial pronouncements to consider due date u/s.139(4) and not u/s. 139(1) – [refer *ITO vs. Gope M. Rochalani [2014] 151 ITD 642 (Mum)*; *Rakesh Nain Trivedi [2015] 152 ITD 869 (Amsr)*]; whereas provisions of sec.271AAB of the Act clearly refers to due date u/s. 139(1) of the Act. Further, there is no reasonable cause provided in the section for not filing return of income in time. However, as per the amendment made in Explanation 4(b), even though there is no such provision in Explanation 5A, credit for the taxes paid for that year ought to be allowed

while computing the amount of penalty for the reason that similar provision for deeming concealment of income exists in *Explanation 3*.

Manner of income and substantiation thereof – when required to do for purposes of penalty provisions

As per the provisions of sections 271AAA / 271AAB of the Act, one of the conditions for claiming immunity from penalty or reduced rate of penalty, as the case may be, is that the assessee must specify the manner of earning undisclosed income in the statement recorded u/s. 132(4) of the Act and also substantiate the same. The question arises is whether it is mandatory for the assessee to specify this or is it necessary for the search officer to ask specific question in this respect while recording statement u/s. 132(4) of the Act and how far the manner of undisclosed income earned is to be substantiated.

In this regard, it was held in the case of *CIT vs. Mahendra C. Shah (2008) 299 ITR 305 (Guj.)* that even if the statement does not specify the manner in which the income is derived, if the income is declared, tax thereon is paid and return is filed including the undisclosed income, there would be substantial compliance not warranting any further denial of the benefit of claiming immunity from penal provisions. Similar view taken in *CIT vs. Radha Kishan Goel [2005] 278 ITR 454 (All)*. There are series of decisions wherein it has been held that if the search officer does not ask any question relating to the manner of earning income or regarding substantiation of the manner of income earned, at a later stage, this cannot be made a hurdle for not granting benefit of immunity/reduced rate while levying penalty. Some of the decisions are – *ACIT vs. Emirates Technologies (P) Ltd. [2017] 58 ITR (Trib.) 593 (Del.)*; *ACIT vs. Ajit Singh [2016] 76 taxmann.com 212 (Jp.)*; *ACIT vs. Shreenarayan Sitaram Mundra [2017] 166 ITD 47 (Ahd.)*; *ACIT*

vs. Smt. Ritu Singhal [2016] 49 ITR (Trib.) 664 (Del). However, recently, the Delhi High Court *vide* order dated 12-3-2018 in ITA 672/2016 has reversed the decision of Delhi ITAT in the case of *ACIT vs. Smt. Ritu Singhal [2016] 49 ITR (Trib.) 664 (Del.)* whereby the Delhi HC held that the assessee did not specify how she derived that income and what head it fell in (rent, capital gain, professional or business income out of money lending, source of the money etc.). Unless such facts are mentioned with some specificity, it cannot be said that the assessee has fulfilled the requirement that she, in her statement (under Section 132(4)) – substantiates the manner in which the undisclosed income was derived. Such being the case, this Court is of opinion that the lower appellate authorities misdirected themselves in holding that the conditions in section 271AAA(2) were satisfied by the assessee. In this decision, the Delhi High Court has considered the decisions of Gujarat HC in *Mahendra C. Shah, supra*, and of Allahabad HC in *Radha Kishan Goel, supra*. In the decision of Delhi HC, it is held as under-

“13. In the present case, during the course of the statement made by the assessee, during the course of the search on 4 March, 2010, that she had lent ₹ 16 crores in aggregate to three individuals during Financial Year 2009-2010. This was in response to a query by the revenue officials during the course of search when the basis of page 81 of Exhibit A-3 was sought to be questioned. To the next question, the assessee replied that the said amount of – ₹ 16 crores is my unaccounted income for the Financial Year 2009-10 relevant for AY 2010-11. However, the requirement of the assessee having to – (ii) substantiates the manner in which the undisclosed income was derived was satisfied. Although a general statement that the undisclosed income was the source of ₹ 16 crore was disclosed, no “substantiation” of the “manner” of deriving such undisclosed income was revealed.

14. In construing Section 271AAA one must not lose sight of its essential purpose which resulted in its enactment. There is a penalty at the rate of 10% of the undisclosed amount declared, if the conditions in Section 271AAA(2) are not met with. This is quite different from the penal provision under Section 271(1)(c) of the Act, which directs that if income is concealed or inaccurate returns are filed, which are disallowed by the AO, the penalty shall be three times the amount of tax sought to be evaded. In the case of amounts disclosed during the course of search, the penalty amount is only ten per cent of the undisclosed income. Parliament has, therefore, given a different treatment to the latter category. At the same time, if an assessee were to successfully urge the “escape route” so to say, of Section 271AAA(2), all three conditions mentioned in the provision, (as held in *Gebilal Kanhailal* in respect of *pari materia* provisions) have to necessarily be fulfilled. In the present case, the assessee, while declaring the “undisclosed income” also stated, that the surrender is being made subject to no penal action of Section 271(1)(c).

15. While dealing with a case of similar surrender – but made in the course of survey proceedings, by an assessee (which led to imposition of penalty), the Supreme Court, in *Mak Data (P) Ltd. vs. Commissioner of Income Tax 358 ITR 539 (SC)* held as follows:

7. The AO, in our view, shall not be carried away by the plea of the assessee like – voluntary disclosure, – buy peace, – avoid litigation, – amicable settlement, etc. to explain away its conduct. The question is whether the assessee has offered any explanation for concealment of particulars of income or furnishing inaccurate particulars of income. Explanation to 271 raises a presumption of concealment, when a difference is noticed by the AO,

between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the Revenue to show that the amount in question constituted the income and not otherwise.

8. Assessee has only stated that he had surrendered the additional sum of ₹ 40,74,000/- with a view to avoid litigation, buy peace and to channelise the energy and resources towards productive work and to make amicable settlement with the Income tax department. Statute does not recognise those types of defences under the Explanation 1 to 271(1)(c) of the Act. It is trite law that the voluntary disclosure does not release the appellant-assessee from the mischief of penal proceedings. The law does not provide that when an assessee makes a voluntary disclosure of his concealed income, he had to be absolved from penalty.

9. We are of the view that the surrender of income in this case is not voluntary in the sense that the offer of surrender was made in view of detection made by the AO in the search conducted in the sister concern of the assessee. In that situation, it cannot be said that the surrender of income was voluntary. AO during the course of assessment proceedings has noticed that certain documents comprising of share application forms, bank statements, memorandum of association of companies, affidavits, copies of Income Tax Returns and assessment orders and blank share transfer deeds duly signed, have been impounded in the course of survey proceedings under Section

133A conducted on 16-12-2003, in the case of a sister concern of the assessee.

16. That the income which was ultimately brought to tax pursuant to the disclosure made, which was voluntary on the part of the assessee is stating the obvious. The assessee merely stated that the sums advanced were undisclosed income. However, she did not specify how she derived that income and what head it fell in (rent, capital gain, professional or business income out of money lending, source of the money etc). Unless such facts are mentioned with some specificity, it cannot be said that the assessee has fulfilled the requirement that she, in her statement (under Section 132(4)) – substantiates the manner in which the undisclosed income was derived. Such being the case, this Court is of opinion that the lower appellate authorities misdirected themselves in holding that the conditions in Section 271AAA(2) were satisfied by the assessee.

17. For the above reasons, it is held that the impugned order is in error; the substantial question of law is answered in favour of the revenue and against the assessee. The appeal is consequently allowed. No costs”.

This being recent decision of the High Court in the context of provisions of section .271AAA of the Act and the conditions laid therein and the decision being rendered after considering the earlier decisions of the High Courts, the liberal interpretation given up till now by the various benches of the Tribunal may require reconsideration and it would therefore not be easy to say henceforth that such question was not asked by the officers since it is for the assessee to reveal the manner as well as substantiate the same.

Thus, the conclusion that can be drawn from the above rulings is that if only some income is admitted and offered to tax without specifying

anything regarding manner & substantiation of earning the same whether or not a specific question is asked in that regard, it may be difficult to still argue that the condition prescribed is fulfilled especially u/s. 271AAB(1) / (1A) of the Act where immunity is provided as to the rate of penalty on the grounds of fulfilling of conditions as prescribed therein.

Return of income filed belatedly i.e. not within due date u/s. 139(1)

In the context of provision of section 271AAB (1) / (1A) of the Act, it is very clearly provided that in order to get immunity of reduced rate of levy of penalty, one of the conditions to be fulfilled is the undisclosed income admitted u/s. 132(4) of the Act is to be disclosed in the return of income filed within the due date prescribed u/s. 139(1) of the Act. This particular condition is totally in contrast to the earlier provision of section 271AAA of the Act or even to Explanation 5A to section 271(1)(c) of the Act. In section 271AAA of the Act, the provision of filing return of income within due date u/s. 139(1) of the Act was not a pre-condition for claiming immunity from penalty. Similarly, as stated earlier, under Explanation 5A to section 271(1)(c) of the Act, what is stated is only due date which has been interpreted to mean due date of filing return of income as provided in section 139(4) of the Act. However, section 271AAB of the Act has prescribed this condition, which is very important to understand. The assessee may fulfil all the other prescribed conditions i.e. offering undisclosed income in statement u/s.132(4), explaining manner of earning income and even substantiating the same, paying taxes on the same with interest, etc., however even after complying with all this, if the assessee for any reason, does not file return of income within the due date prescribed u/s. 139(1) of the Act, then no immunity from penalty would be allowed in respect of reduced rate of penalty and the penalty would be levied at the maximum rate applicable. Here it is also pertinent to note that no reasonable cause

provision is laid down to suggest that if the delay is attributable to department for not giving copies of seized material immediately or in a case where there are voluminous seized paper which takes time to exactly compute the amount of undisclosed income or for any other reason, even then penalty would be levied at the maximum rate prescribed in the said section. If any such eventuality exist, it would be advisable to file the return of income within the prescribed due date disclosing at least the admitted undisclosed income in the statement recorded so that to this extent the penalty would be liable at the minimum rate prescribed and if anything is discovered later on, only to that extent penalty would be levied at the maximum rate prescribed.

No difference between income disclosed in section 153A return and assessment order – whether penalty leviable

In *Prem Arora vs. Dy. CIT [2012] 149 TTJ 590 (Del.)* it is held that income returned u/s. 153A accepted by AO without any variation though the income disclosed in 153A return was over and above the original returned income – no penalty can be levied in such cases. The Tribunal has given detailed reason for the same and held that – words used ‘notwithstanding anything contained’, the provisions of sections 139, 148 etc. are not applicable & therefore the provisions of section 153A is a complete code in itself and thus, irrespective of whether the earlier returns abate or not, there is no concealment in return u/s. 153A. It is also held categorically that – there is complete detachment of assessment proceedings u/s. 143(3) or 147 from search proceedings u/s. 153A. When scheme of search assessment as designed by the legislature does not prescribe to take into account the earlier assessment proceedings whether abated or not, it will not be proper or justified to refer to returned income u/s. 139 for the purpose of

imposition of penalty u/s. 271(1)(c). It follows that the concealment of income has to be seen with reference to additional income brought to tax over and above income returned by the assessee in response to notice issued u/s. 153A. Accordingly, for the purpose of imposition of penalty u/s. 271(1)(c) resulting as a result of search assessments made u/s. 153A, the original return of income filed u/s. 139 cannot be considered. Further, in case of search initiated after 1-6-2003 a return of income is always filed on issue of notice u/s. 153A. As held above the penalty u/s. 271(1)(c) is imposable when there is variation in assessed and returned income. If there is no variation, there will be no concealment. When there is no concealment, question of levy of penalty u/s. 271(1)(c) will not arise. This is settled position of law. The concept of voluntary return of income may be important in penalty proceedings initiated in course of normal assessment proceedings made u/s. 143(3) or 147 but not under section 153A.

However, the above decision was rendered prior to amendment carried out by inserting Explanation 5A to section 271(1)(c) of the Act. After insertion of *Explanation 5A* to section 271(1)(c) of the Act, irrespective of whether the returned income u/s. 153A of the Act is accepted as it is by the AO, penalty is attracted and there is no escapement from the same as already discussed above.

Conclusion

As could be seen, there is no way under the normal provisions to come out of the rigours of penalty that gets attracted in a case where search action is initiated u/s.132 of the Act. However, the following table would give some breather to the assessee from the rigours of penalty provisions in cases where search action is already conducted or cases where the assessee wants to disclose undisclosed income without a search action getting carried out against him and also to avoid penalty.

Section	245H(1)	273A	273AA w.e.f. 1-4-2008
Competent Authority	Settlement Commission	Pr. Commissioner or Commissioner with prior approval	Pr. Commissioner or Commissioner after abatement from Settlement Commission
Conditions prescribed therein	<ul style="list-style-type: none"> a. co-operated with the Settlement Commission b. has made a full and true disclosure of his income and the manner in which such income has been derived 	<ul style="list-style-type: none"> a. prior to the detection by the Assessing Officer, of the concealment of particulars of income or of the inaccuracy of particulars furnished in respect of such income, voluntarily and in good faith, made full and true disclosure of such particulars b. has co-operated in any enquiry relating to the assessment of his income c. and has either paid or made satisfactory arrangements for the payment of any tax or interest payable in consequence of an order passed under this Act in respect of the relevant assessment year 	<ul style="list-style-type: none"> a. he has made an application for settlement under section 245C and the proceedings for settlement have abated under section 245HA b. the penalty proceedings have been initiated under this Act c. if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived

All the above three sections of the Income-tax Act, 1961 provide for immunity from penalty subject to fulfilment of conditions prescribed therein. The assessee should apply for any of the above 3 options which best suits to the facts and circumstances of his case. It is also pertinent to note that the above options are available to the assessee only once in the lifetime.

Things do not grow better. They remain as they are; and we grow better by the changes we make in them.

— Swami Vivekananda



CA Rajesh P. Shah

Penalties on International Transaction

Penalty as the name suggest brings pressure in the mind of the person. The Incometax Act has prescribed variety of penalties for the omission and errors carried out by the assessee.

In fact for every inaction or the wrong action, the law has series of penalty for the assessee.

This topic will cover the penalties that are leviable by the Income Tax Department on the International transactions.

With India moving to the developed nation from the developing one, many entrepreneurs are moving to cross border transactions which are capital or revenue in nature. In the backdrop of increase in volume of transaction by the Indian residents and the overseas company carrying on transaction in India the corresponding compliance has gone a sea change.

The Government introduced earlier penalty u/s 271AA which was as meagre as One lakh keeping line with penalty for non-filing of audit report. However with effect from 1st July, 2012, penalty for non-reporting of an international transaction in report filed under Section 92E or maintenance or furnishing of incorrect information or documents has been increased to 2% of the value of the international transaction, if the taxpayer-

(i) fails to maintain prescribed documents or information; or

- (ii) fails to report any international transaction which is required to be reported; or
- (iii) maintains or furnishes any incorrect information or documents.

This penalty would be in addition to penalties in sections 271BA and 271G.

Recently by Finance Act, 2016 section 271AA is amended so as to provides that if any person fails to furnish the (BEPS – related) information and document as required under section 92D(4) the prescribed Income-tax authority may direct that such person shall be liable to pay a penalty of ₹ 5,00,000

Indian Government is party to Multi Lateral Instruments (MLI) and committed to implement the same in India.

Following are the requirements of maintenance of record u/ss. 92D(1), (2) & (4).

- (1) Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed:

[Provided that the person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed.]

Explanation.— *For the purposes of this section, —*

(A) *"constituent entity" shall have the meaning assigned to it in clause (d) of sub-section (9) of section 286;*

(B) *"international group" shall have the meaning assigned to it in clause (g) of sub-section (9) of section 286.]*

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

[4) Without prejudice to the provisions of sub-section (3), the person referred to in the proviso to sub-section (1) shall furnish the information and document referred to in the said proviso to the authority prescribed under sub-section (1) of section 286, in such manner, on or before the date, as may be prescribed.]

10D . (1) Every person who has entered into an international transaction [*or a specified domestic transaction*] shall keep and maintain the following information and documents, namely:—

(a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions [*or specified domestic transactions, as the case may be,*] have been entered into by the assessee, and ownership linkages among them;

(c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

(d) the nature and terms (including prices) of international transactions [*or specified domestic transactions*] entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction [*or the specified domestic transaction*];

(f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions [*or the specified domestic transactions*] entered into by the assessee;

(g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions [*or the specified domestic transactions*] entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions [*or specified domestic transactions, as the case may be*];

- (h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction *[or specified domestic transaction]*;
 - (i) a description of the methods considered for determining the arm's length price in relation to each international transaction *[or specified domestic transaction]* or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
 - (j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction *[or the specified domestic transaction]* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
 - (k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
 - (l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;
 - (m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.
- o Nature of default / failure to report & Furnishing of incorrect information/ documents along with quantum of penalty

271AA	Penalty for : <ul style="list-style-type: none"> • Failure to maintain documentation prescribed under Section 92D of the Act • Failure to report a transaction, or • Maintaining or furnishing incorrect information / document 	2% of the value of international transaction or specified domestic transaction
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The law is evolving and accordingly the department is trying to levy penalty for all such failure by the assessee. However the judiciary has held in few cases that penalty is not the automatic levy and should see the reasonableness before levy of penalty.

Few Case Laws to support the view are as follows:-

[2016] 68 taxmann.com 185 (Jaipur – Trib.)

Assistant Commissioner of Income-tax, Circle-6, Jaipur vs. Integrated Decisions & Systems (India) (P.) Ltd.*

Section 271AA, read with section 92D, of the Income-tax Act, 1961 and rule 10D of the Income-tax Rules, 1962 – Transfer pricing - Penalty for failure to keep and maintain information and documents in respect of international transactions under section 92D - Assessment year 2006-07 – Assessee was engaged in development and online support

of software – Assessing Officer found that assessee failed to maintain records relating to international transactions as required under rule 10D and provided only updated margin for same comparables as selected for financial year 2004-05 – He, therefore, imposed penalty under section 271AA – Department had not controverted that assessee had provided similar services during year under consideration as provided in financial year 2004-05 and, therefore, comparable companies applied for financial year 2004-05 were relevant to transactions made during financial year 2005-06, which was also updated by assessee – Further, whatever information was asked to supply by TPO had been furnished by assessee before him – Whether on facts, penalty was to be deleted – Held, yes [Para 5] [In favour of assessee] [2016] 68 taxmann.com 185

[2014] 52 taxmann.com 205 (Mumbai – Trib.) Deputy Commissioner of Income-tax, Circle-10 (1), Mumbai vs Kodak Graphic Communication India Ltd.*

Section 92D, read with section 271AA, of the Income-tax Act, 1961 and rule 10D, of the Income-tax Rules, 1962 – Transfer Pricing - Maintenance of accounts and documents (Comparables and adjustment – Penalty) - Assessment year 2007-08 – Assessee-company, wholly owned subsidiary of a foreign company, had international transactions with its AE - Assessee had filed its audit report in Form No. 3 CEB, highlighting international transaction and had also done benchmarking of arm's length price in relation to said transaction – Assessee had also complied with all notices sent by Transfer Pricing Officer and clause by clause documentation required under rule 10D had been made by assessee – Whether, on facts, penalty under section 271AA could be imposed on assessee – Held, no

[2013] 33 taxmann.com 504 (Mumbai – Trib.) Mehta Brothers Exports vs. Deputy Commissioner of Income-tax, Circle 16(3)*

Section 92D, read with section 271AA, of the Income-tax Act, 1961 – Transfer Pricing – Maintenance and keeping of accounts – During course of assessment proceedings, Assessing Officer observed that assessee's transaction with P, which was stated to be an entity registered in Belgium owned by brother of one of partners of assessee-firm, was between associated enterprises – Assessing Officer further observed that assessee had shown same transaction with P in Form No. 3CD as transaction covered under section 40A(2)(b) – He worked out excessive payment made to P and, accordingly, made addition under section 40A(2)(b) –

Thereafter, penalty proceedings were initiated and penalty was imposed under section 271AA – Commissioner (Appeals) classified transaction under clause (j) of section 92A and held assessee and 'P' to be associated enterprises – In absence of assessee having maintained documents and information as prescribed under rule 10D, Commissioner (Appeals) held that there was a default under section 92D requiring imposition of penalty under section 271AA – Whether when assessee was consistently harping on view that P was not its associated enterprises and such opinion was supported by an article, there was a good ground for believing that both were not associated enterprises and as such there was no need to maintain records/documents as per section 92D – Held, Yes – Whether, therefore, assessee was covered under shelter of section 273B, requiring non-imposition of any penalty under section 271AA – Held, yes – Whether since, Assessing Officer had proceeded by applying provisions of section 40A(2) and Transfer Pricing provisions under Chapter X had not been invoked for making addition, Assessing Officer impliedly restricted his scope to section 40A(2) alone – Held, yes - Whether if Assessing Officer had not considered it as an international transaction between two associated enterprises, provisions of section 92D requiring maintenance of information and documents in respect of an international transaction could not be applied and, thus, section 271AA could not be applied – Held, Yes

Section 271G as amended by the Finance Act, 2012 with effect from assessment year 2013-14 provides that if any person who has entered into an international transaction/SDT fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the international transaction/ SDT for each such failure.

Finance (No. 2) Act, 2014 has amended section 271G to include Transfer Pricing Officer as referred to in section 92CA, as an authority competent to levy the penalty under section 271G in addition to the Assessing Officer and the Commissioner (Appeals).

The existing provisions of section 271G of the Act provide that if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such document or information as required by sub-section (3) of section 92D, then such person shall be liable to a penalty which may be levied by the Assessing Officer or the Commissioner (Appeals).

Section 92CA provides that an Assessing Officer may make reference to a Transfer Pricing Officer (TPO) for determination of arm's length price (ALP).

TPO, as referred to in section 92CA, is also included as an authority competent to levy the penalty under section 271G in addition to the Assessing Officer and the Commissioner (Appeals).

92D(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction or specified domestic transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard; provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person,

extend the period of thirty days by a further period not exceeding thirty days.

Nature of default , authority levying penalty & quantum of penalty

271G. If any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Transfer Pricing Officer as referred to in section 92CA or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction or specified domestic transaction for each such failure.

271G	Failure to furnish any information or document as required by section 92D(3)	2% of the value of the international transaction/specified domestic transaction for each failure
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Case Laws

Assistant Commissioner of Income-tax, Mumbai vs. D. Navinchandra Exports (P.) Ltd.* [2017] 87 taxmann.com 306 (Mumbai – Trib.)

Section 92D, read with section 271G, of the Income-tax Act, 1961 – Transfer pricing – Maintenance and keeping of information and accounts (penalty u/s. 271G) – Assessment year 2011-12 – Whether where TPO directed assessee-diamond merchant to furnish segmental profitability for AE transactions and non-AE transactions, since practical difficulty in furnishing segment wise profit & loss account of AE segment and non-AE segment was expressed by diamond industry, penalty under section 271G was not called for – Held, yes.

Worlds Window Impex (India) (P.) Ltd. vs. Assistant Commissioner of Income-tax, Central Circle-6*

[2016] 69 taxmann.com 406 (Delhi – Trib.) Section 92D, read with section 271G, of the Income-tax Act, 1961 and rule 10D of the

Income-tax Rules, 1962 – Transfer pricing – Maintenance and keeping of information and documents – Assessment Year 2009-10 – In his order passed under section 92CA, TPO accepted international transactions of assessee with its AE at arm's length – However, he levied penalty under section 271G for not filing TP study report as prescribed under Rule 10D, in time - Facts revealed that all details relevant to TP assessment were provided by assessee before completion of order under section 92CA(3) by TPO and after examination of such details international transactions entered into by assessee were found to be at arm's length - In his order, TPO did not point out specifically which information was not provided by assessee in time - Whether on facts, penalty was to be deleted - Held, yes.

Commissioner of Income-tax-I vs. Bumi Hiway (I) (P.) Ltd.*

Section 92D, read with section 271G, of the Income-tax Act, 1961 - Transfer pricing - Maintenance and keeping of Information and document (Penalty) - Assessment year 2005-06 - Whether where Transfer Pricing Officer had asked for specific details and documents and these requirements were fully complied with by assessee company, penalty under section 271G could not be imposed – Held, yes.

Section 285BA has been recently introduced to cover various types of reporting to the Income Tax Department. Since the section is all about reporting of information, stringent penalties are prescribed so that the assessee adhere to the time line for reporting the same.

Section 285A reads as follows:-

Where any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly or indirectly, its value substantially from the assets located in India, as referred to in *Explanation 5* to clause (i) of sub-section (1) of *section 9*, and such company or, as the case may be, entity, holds, directly or indirectly, such assets in India through, or in, an Indian concern, then, such Indian concern shall,

for the purposes of determination of any income accruing or arising in India under clause (i) of sub-section (1) of section 9, furnish within the prescribed period to the prescribed income-tax authority the information or documents, in such manner, as may be prescribed.]

Information and documents as per Rule 114DB for section 285BA

- (i) details of the immediate holding company or entity, intermediate holding company or companies or entity or entities and ultimate holding company or entity of the Indian concern;
- (ii) details of other entities in India of the group of which the Indian concern is a constituent;
- (iii) the holding structure of the shares of, or the interest in, the foreign company or entity before and after the transfer;
- (iv) any transfer contract or agreement entered into in respect of the share of, or interest in, any foreign company or entity that holds any asset in India through, or in, the Indian concern;
- (v) financial and accounting statements of the foreign company or entity which directly or indirectly holds the assets in India through, or in, the Indian concern for two years prior to the date of transfer of the share or interest;
- (vi) information relating to the decision or implementation process of the overall arrangement of the transfer;
- (vii) information in respect of the foreign company or entity and its subsidiaries, relating to —
 - (a) the business operation;
 - (b) personnel;
 - (c) finance and properties;
 - (d) internal and external audit or the valuation report, if any, forming basis of the consideration in respect of shares, or the interest;

- (viii) the asset valuation report and other supporting evidence to determine the place of location of the share or interest being transferred;
- (ix) the details of payment of tax outside India, which relates to the transfer of the share or interest;
- (x) the valuation report in respect of Indian asset and total assets duly certified by a merchant banker or accountant with supporting evidence;
- (xi) documents which are issued in connection with the transactions under the accounting practice followed.

Nature of default, Authority levying penalty & quantum of penalty

271GA. If any Indian concern, which is required to furnish any information or document under section 285A, fails to do so, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern shall pay, by way of penalty:—

- (i) a sum equal to two per cent of the value of the transaction in respect of which such failure has taken place, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern;
- (ii) a sum of five hundred thousand rupees in any other case.

Section 286 has been recently introduced to cover various types of reporting to the Income Tax Department. Since the section is all about reporting of information, stringent penalties are prescribed so that the assessee adhere to the time line for reporting the same.

Section 286 reads as follows:

- 1) *Every constituent entity resident in India, shall, if it is constituent of an international group, the parent entity of which is not resident in India, notify the prescribed income-*

tax authority (herein referred to as prescribed authority) in the form and manner, on or before such date, as may be prescribed.

Every parent entity or the alternate reporting entity, resident in India, shall, for every reporting accounting year, in respect of the international group of which it is a constituent, furnish a report, to the prescribed authority on or before the due date specified under sub-section (1) of section 139, for furnishing the return of income for the relevant accounting year, in the form and manner as may be prescribed.

RULE 10DA– FORM NO. 3CEAA (MASTER FILE) & FORM 3CEAB

RULE 10DB – FORM NO. 3CEAC & 3CEAD (COUNTRY-BY-COUNTRY REPORT)

271GB (1) If any reporting entity referred to in section 286, which is required to furnish the report referred to in sub-section (2) of the said section, in respect of a reporting accounting year, fails to do so, the authority prescribed under that section (herein referred to as prescribed authority) may direct that such entity shall pay, by way of penalty, a sum of —

- (a) five thousand rupees for every day for which the failure continues, if the period of failure does not exceed one month; or
 - (b) fifteen thousand rupees for every day for which the failure continues beyond the period of one month.
- (2) Where any reporting entity referred to in section 286 fails to produce the information and documents within the period allowed under sub-section (6) of the said section, the prescribed authority may direct that such entity shall pay, by way of penalty, a sum of five thousand rupees for every day during which the failure continues, beginning from the day immediately following the day on which

the period for furnishing the information and document expires.

- (3) If the failure referred to in sub-section (1) or sub-section (2) continues after an order has been served on the entity, directing it to pay the penalty under sub-section (1) or, as the case may be, under sub-section (2), then, notwithstanding anything contained in sub-section (1) or sub-section (2), the prescribed authority may direct that such entity shall pay, by way of penalty, a sum of fifty thousand rupees for every day for which such failure continues beginning from the date of service of such order.
- (4) Where a reporting entity referred to in section 286 provides inaccurate information in the report furnished in accordance with sub-section (2) of the said section and where—
 - (a) the entity has knowledge of the inaccuracy at the time of furnishing the report but fails to inform the prescribed authority; or
 - (b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or
 - (c) the entity furnishes inaccurate information or document in response to the notice issued under sub-section (6) of section 286, then, the prescribed authority may direct that such person shall pay, by way of penalty, a sum of five lakh rupees

Section 195 has gained importance in view of the large scale remittance being made by the Indian party to the overseas company.

Government has introduced new sub-section (6) to section 195 wherein the person responsible for paying to a non-resident, not being a company,

or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in Form 15CA, 15CB & 15CC. Failure to furnish information under sub-section (6) of section 195, or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one lakh rupees.

Few interesting aspects viz. penalties u/ss. 271AA, 271BA and 271G can be initiated in parallel to the assessment proceedings once the contraventions prescribed therein come to the notice of the tax officers. Penalty u/s. 271G can be levied, if the requested documents are not submitted within 30 days (can be further extended by another 30 days at the discretion of the officer) from the receipt of the notice.

In case of M/s. Annapura Business Solutions [17], the Hyderabad Tribunal deleted the penalty u/s. 271G observing that the taxpayer had furnished all particulars on the basis of which the AO could determine the ALP and the taxpayer had reasonable cause to not furnish additional information required by the AO as they were not available in public domain.

Another point of debate between penalty u/s. 271AA and 271G is if a taxpayer has not maintained the required documentation (which therefore cannot be furnished to the tax officer), whether a penalty of 2% or 4% will be attracted. This becomes very critical for taxpayers as the penalty is not based on the tax evaded but on the values of the international / specified domestic transactions and can be much more burdensome than other penalties.

Also, penalties under these sections can be levied even when the ALP of the transactions as determined by the taxpayer is accepted by the tax officer. Also, in a reverse situation, where the documentation is maintained but not furnished, a similar challenge may be faced by the taxpayer to demonstrate that it has maintained the required documentation to avoid penalty u/s. 271AA.

To summarise various types of penalties on the international transactions are as follows:-

PENALTIES

Section (1)	Nature of default (2)	Penalty leviable (3)
271AA(1)	(1) Failure to keep and maintain information and documents required by <u>section 92D(1)</u> or <u>92D(2)</u> (2) Failure to report such transaction (3) Maintaining or furnishing incorrect information or document	2% of value of each international transaction/or specified domestic transaction entered into
271AA(2)	Failure to furnish information and document as required under <u>Section 92D(4)</u>	₹ 5,00,000/-
271BA	Failure to furnish a report from an accountant as required by section 92E	₹ 1,00,000
271G	Failure to furnish any information or document as required by section 92D(3)	2% of the value of the international transaction/specified domestic transaction for each failure
271GA	<u>Section 285A</u> provides for reporting by an Indian concern if following two conditions are satisfied: a) Shares or interest in a foreign company or entity derive substantial value, directly or indirectly, from assets located in India; and b) Such foreign company or entity holds such assets in India through or in such Indian concern. In this case, the Indian entity shall furnish the prescribed information for the purpose of determination of any income accruing or arising in India under <u>Section 9(1)(i)</u> . In case of any failure, the Indian concern shall be liable to pay penalty.	Penalty shall be: a) a sum equal to 2% of value of transaction in respect of which such failure has taken place, if such transaction had effect of, directly or indirectly, transferring right of management or control in relation to the Indian concern; b) a sum of ₹ 5,000 in any other case.
271GB(1)	Failure to furnish report under <u>section 286(2)</u>	₹ 5,000 per day upto 30 days and ₹ 15,000 per day beyond 30 days
271GB(2)	Failure to produce the information and documents within the period allowed under <u>section 271GB(6)</u>	₹ 5,000 for every day during which the failure continues
271GB(3)	Failure to furnish report or failure to produce information/documents under section 286 even after serving order under <u>section 271GB(1)</u> or <u>271GB(2)</u>	₹ 50,000 for every day for which such failure continues beginning from the date of serving such order.
271GB(4)	Failure to inform about inaccuracy in report furnish under <u>section 286(2)</u> Or furnishing of inaccurate information or document in response to notice issued under <u>section 286(6)</u> .	₹ 5,00,000
271-I	As per <u>section 195(6)</u> of the Act, any person responsible for paying to a non-resident or to a foreign company, any sum (whether or not chargeable to tax), shall furnish the information relating to such payment in Form 15CA and 15CB. Penalty shall be levied in case of any failure.	₹ 1,00,000

Conclusion

Provisions of penalties are rigorous and need to be handled with utmost care, as the only remedial measure available against the same is a appeal on the ground of reasonable cause.

In many cases, the amount is linked to the amount of transaction involved and hence the quantum of penalty can be very huge in comparison to the disputed tax amount.

However in many practical cases, the judicial authorities have verified the reasoning behind the omission and default before deleting the said penalty.

□□□



CA Ashok Mehta

"Penalties for non-payment of tax" and "Penalty proceedings – Initiation, Limitation and Completion"

Section 221: Penalty for default in payment of tax

History and background

The section is on the same lines as S. 46(1) and 46(1A) of the Income-tax Act 1922. The section provides for levy of penalty for non-payment of tax. Where the assessee has defaulted in payment of tax or is deemed to be in default, the assessing officer is entitled to levy penalty in addition to the interest payable under sub-section 2 of section 220 of the Income-tax Act 1961 (hereinafter referred to as "the IT Act"). Though the section is on the same lines as the law under the Income-tax Act, 1922 there are some major differences between the old provision and the new section (which has been amended many times over the years). The difference have been brought out hereunder and therefore all the old judgments may not be applicable to the current section 221 in the current form.

Though the section is for levy of penalty, the said section is placed under Chapter of XVI-D Collection and Recovery and not under Chapter XXI – Penalties Imposable. This arrangement is indicative of the fact that it is to be used as a

deterrent to non-payment of taxes or delay in payment of taxes.

The levy of penalty is not automatic. On the default in payment of taxes the assessing officer is required to issue a notice to assessee to show cause as to why the penalty should not be levied for default in payment of tax. The said process of issue of show cause notice is a must for levy of penalty under the section (first proviso) and non-issue of such a notice would lead to levy of penalty being void.

Onus to prove good and reasonable cause

The onus to prove that there was good and sufficient reason for non-payment of tax has shifted to the assessee from 10-9-1986 by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (second proviso). Prior to this the assessing officer could levy penalty only if he was satisfied that the default was without good and sufficient reasons. He was to prove the existence of a culpable state of mind on the part of assessee. This would make the levy of penalty very difficult for the assessing officer. After the amendment it is the assessee's responsibility to satisfy the assessing officer that the default was

for good and sufficient reason. What is a good and sufficient reason for non-payment would depend on the facts of each case.

However, the assessing officer cannot levy penalty because it can be legally levied, the Kerala High Court in the case of *E. K. Varghese vs. ITO (1974) 96 ITR 577* by following the Supreme Court Judgment in the case of *Hindustan Steel Ltd. vs. State of Orissa (1972) 83 ITR 26* stated that something more must be shown and that is whether there is dishonest conduct on the part of the defaulter who is said to have committed the breach. The Kerala High Court further went on to observe after comparing the pre-and-post amended section 221 that “I am, therefore, of the view that the amendment did not really effect any change in the law. In order to justify the imposition of a penalty under s. 221, the ITO should not only find that there is default but should also consider the question whether there was good and sufficient reason for the default and only if he finds that there were none, he could proceed to impose the penalty. In other words, the situation prior to the amendment of 1970 was the same as that after such amendment.” A similar view was also taken by the Madhya Pradesh High Court in the case of *Addl. CIT vs. Kalayanmal Mills Ten Factory 116 ITR 881*.

Default in payment of tax

The section refers to the default in payment of tax. The term tax is defined under section 2(43) of the IT Act. The said definition includes income tax, super tax and fringe benefit tax, but does not include interest or penalty. Thus penalty under this sections is to be restricted to the tax default and does not include the interest under sections 234A, 234B, 234C, 220(2) or penalty. The issue whether penalty could be levied on default in payment of interest or penalty was decided in favour of assessee in the judgment of *CIT vs. Oryx Finance and Investment Pvt. Ltd. (Bombay High Court) 395 ITR 745*. (Also *CIT vs. P. S. Hathiramani 207 ITR 483(Bom.)*)

Leviability of Penalty

The section refers to “when assessee is in default or deemed to be in default”, therefore is it necessary that the assessee should be in default when the penalty is being levied? The assessee has defaulted in payment of self-assessment tax / TDS, however he pays the tax with interest before the receipt of the notice for penalty, Can the penalty be levied as the assessee has paid the taxes and is not in default when the notice is issued?. The explanation to the section inserted from 1-10-1975 has changed the law. The explanation makes it clear that even if the payment is made before the levy of the penalty the assessee is in default and penalty is leviable. This is in variance to the earlier position of law, where penalty was not levied if the tax was paid before the imposition of penalty. The old circular stating that the penalty should not be levied in case the tax is paid before levy of the penalty has been withdrawn from 14th September 1979. The assessee in the case of *CIT vs. Vijayanthimala 108 ITR 882* raised a similar argument but the same was rejected by the High Court.

An identical argument is placed with regard to the issue whether when self-assessment tax is not paid with the original return, but is paid with the revised return, is the penalty leviable for the non-payment of such self-assessment tax with the original return? There is a Lucknow Bench decision in the case of *ACIT vs. Shri Shakti Credits Limited I(2014) 66 SOT 0175 (Lucknow)* which had in the context of section 140(3) held in favour of assessee on identical facts, that the penalty cannot be levied. The Ahmedabad Tribunal was not in agreement with the said view and hence a Special Bench was formed. The Ahmedabad Special Bench in case of *Claris Life Sciences Limited vs. DCIT (59 ITR (Trib.) 450)* decided against the assessee in the above issue and held that the non-payment of tax with the original return was a default on which penalty can be levied.

Default in payment of TDS

Whether the failure to deduct TDS would be covered under 271C and therefore would not be covered under section 221? Can one therefore say that penalty cannot be levied under section 221? The *Kolkata Tribunal in the case of ITO vs. Titagarh Steels Ltd. (2001) 79 ITD 0532* and the Mumbai Tribunal in the case of *Industrial Development Bank of India vs. Income Tax Officer (2007) 107 ITD 0045* have held that default on account of deduction of tax at source cannot be visited with penalty under s. 221. If one was to accept the proposition that the penalty can be levied under section 221 for default in payment of TDS, then can it be said that the penalty can again be levied under section 271C? There is no definite answer, whereas the Constitution [Article 20(2)] does not allow punishment for the same offence twice, penalty is not a punishment and as per the Supreme Court (*Dharmendra Textiles*) is a civil liability, it would be possible to argue that the law provides for penalising the assessee twice under two sections as a deterrent. However, the section 221 is a general section levying penalty for non-payment of tax, whereas the section 271C is a specific section for non-payment of TDS and therefore as per rule of interpretation the specific would prevail over the general. Thus after the introduction of 271C (from A. Y. 1989-90) penalty for non payment of TDS cannot be levied under section 221.

Default in payment of Advance Tax

The Courts have held that the non-payment of advance tax after an order under section 210 (3) or 210(4) by issue of notice under section 156, is a default in payment of tax as the Courts have held that advance tax is also a tax and once assessee has been held as assessee in default under section 218 penalty under section 221 is leviable. [*CIT vs. Shreerama & Co. 101 ITR 531 (AP)*, *UOI vs. Sikri & Sons 112 ITR 529*. However if the assessee has provided the estimation under section 210(5) in the prescribed Form 28 and paid the advance tax as per the said estimation

then the assessing officer is not justified in levying of penalty.

Can the penalty levied be reduced in appeal by the appellant authority

The penalty to be levied by the assessing officer, is at the discretion of the assessing officer subject to the maximum limit that the total penalty amount not to exceed the amount of tax, for non payment of which, penalty is to be levied. The penalty levied can be reduced by the appellant authority depending on the facts of the case.

Financial Difficulty as a reason for default

The assessee in majority of cases, raises the plea of financial difficulty in payment of taxes. However, the assessee has to lead documentary evidences to prove the financial difficulty and the mere statements or affidavits would not be accepted by the assessing officer or the courts. This legal position has been confirmed even by the Bombay High Court in the case of *Reliance Industries Ltd. (377 ITR 74,)* para 27, where the evidence to prove financial difficulty was not presented, the plea for good and sufficient reason for default was rejected. Similar view has been taken by the various Tribunals (*ITO vs. Devsons 113 TTJ 0615*, *DCIT vs. Aanjenya Life Care Ltd. Mumbai*). The assessee can however not take the plea of financial difficulty in the case of TDS as the same is deducted from payment made to the third party. (*ACIT vs. Kangra Valley Investment & Finance Co. Ltd. (2002) 80 ITD 0025 (Kol.)*).

Penalty can be modified based on final order

The sub-section 2 of the section provides for a situation where after the levy of the penalty the amount payable by the assessee is reduced or deleted under an appeal or revision or rectification process. The sub-section provides that in case of reduction or complete deletion of

the demand the penalty order will be modified and penalty collected in excess would have to be refunded. However such modification of penalty order will have to be done after the assessment has achieved finality. *Khubchand Narsing Das vs. CIT 104 ITR 0602*. In this case there was no appeal or reference against the order of ITAT making the assessment to nil value. The Court held that since there was no appeal or reference to the High Court or Supreme Court the order of ITAT has become final and hence the order under section 221 penalty levied has to be modified to nil. However the fact, that the matter had to travel up to the Orissa High Court, indicates the difficulty faced by the assessee. The section does not provide for a time frame within which such order should be passed in subsection 2. One would have to practically apply to the assessing officer for such modification and claim the refund. A time frame for passing of such orders would help the assessee.

Section 275: Bar of Limitation in levy of penalty

History and Background

The section was introduced by the Taxation Laws (Amendment) Act 1970, w.e.f. 1-4-1971 based on the recommendations of the Direct Taxes Administration enquiry committee report (Ch. 7, para 63). The Income-tax Act 1922 did not have any time limit for levy of penalty. However, the Courts have held that there should not be any inordinate delay in levy of penalty. (*K. P. Narayanappa Shetty & Co. (1975) 100 ITR 17 (AP)*). However, the inordinate delay would have different interpretation depending on the facts of each case. There was a case where the penalty notice was issued after a delay of more than 12 years. It was held to be an abuse of power and the penalty notice was quashed in writ. [*Ram Krishna Baldeo Prasad vs. CIT 65 ITR 491 (All)*, *Mohd. Atiq vs. ITO 46 ITR 452 (All)*.]

However, the Bombay High Court in the case of *Lalta Prasad Goenka 122 ITR 399* held that the decision of Allahabad High Court in *Mohd. Atiq (supra)* did not lay any general principle that every delayed order of penalty must be invalid merely on grounds of delay. The Orissa High Court also held that where no time limit has been prescribed in the relevant statute for imposition of penalty, it is not open to the High Court to read into the statute a limitation which the legislature has not provided for. (*Ramratan Motilal vs. State of Orissa (1992) 87 STC 457, 459*). Thus there was a need to decide on the limit for levy of penalty.

The section 275 introduced in the statute from A Y 1971-72 provides for limits beyond which levy of penalty is time-barred. The section has been amended over the years and the changes have been made to the time limit provided to levy penalty. A question which arises if there is a change in time-limit under section for levy of penalty would it be prospective or retrospective. The limitation in levy of penalty is a procedural law and any amendment in the procedural law is normally retrospective and applies to pending proceedings. In that view of the matter, the levy of penalty will be governed by the law at the point of initiation of penalty proceedings and not by the law in force at the time of filing of return (*Rampur Finance Corporation Ltd. 194 ITR 442 (All)*). However, if the point of time when the change of law happens the limitation for imposing penalty under s. 271(1)(c) had already expired then penalty will be time-barred and the retrospective law cannot apply to such cases. (*CIT vs. Braj Bhushan Cold Storage 275 ITR 360*.)

Limitation for levy of penalty

The section divides the cases into four categories while setting out the limit beyond which penalty cannot be levied. Thus the penalty levied after the limitation period is time barred and is to be deleted.

Category	Limitation
Relevant Assessment order or other order is in Appeal to the <ul style="list-style-type: none"> – Commissioner Appeal u/s. 246 or 246A. – Appeal to the ITAT u/s. 253 	No penalty will be levied <ul style="list-style-type: none"> – Ater the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated. OR
	<ul style="list-style-type: none"> – Six months from the end of the month in which the order of the CIT(A) or as the case ITAT is received by the PR. Chief CIT or Chief CIT or PR. CIT or CIT. Which every is later
Relevant Assessment order or other order is in Appeal to the <ul style="list-style-type: none"> – Commissioner appeal u/s 246 or 246A. – And the Commissioner of (Appeals) passes the order on or after 1st June, 2003 disposing the appeal. [Proviso to Section 275(1)(a)]	No penalty will be levied <ul style="list-style-type: none"> – Ater the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated. OR – One Year from the end of the month in which the order of the CIT(A) is received by the PR. Chief CIT or Chief CIT or PR. CIT or CIT. Which every is later(*)
Where the relevant assessment order or other order <ul style="list-style-type: none"> – is the subject matter of revision under section 263 or section 264. 	No penalty will be levied. <ul style="list-style-type: none"> – After the expiry of six months from the end of the month in which the order of revision is passed.
In any other case.	No penalty will be levied <ul style="list-style-type: none"> – Ater the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated. OR – Six months from the end of the month in which action for imposition of penalty is initiated.

However, the explanation to the section provides for exclusion of certain period in the calculation of the limit beyond which penalty cannot be levied.

- Time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129. (Change of incumbent doing assessment and the assessee seeks a rehearing of the proceedings already completed by previous officer.)

- Any period during which immunity grant under section 245H remained in force. (Settlement Commission giving immunity subject to conditions and the conditions not fulfilled at a later period then the period of granting immunity and then withdrawal is to be reduced from limitation period above)
- Any period during which a proceeding under this Chapter for the levy of penalty is stayed by the order or injunction of court.

Initiation of penalty

The section provides for a limit within which penalty proceedings must be concluded or passed, it does not provide for the stage after which penalty proceedings can or cannot be commenced. Thus a default in getting the books of account audited (271B) can be initiated at any point of time and the only limitation put up by section 275 is that the order should be passed within six months of the said notice issued or by the end of financial year in the course of which action for the imposition of penalty has been initiated. [275(1)(c)] It can be argued that the initiation of penalty proceedings after a long period is an abuse of power but would be difficult to argue as the court would not interfere in the matter unless the delay is unreasonable. (beyond six years). In the case of *Bharat Construction Company vs. ITO* [(1999) 153 CTR 0414] the notice for 271B (failure to get the books of account audited) default was initiated separately and not initiated with the assessment order and the notice under section 271A (failure to maintain the books of account). It was held that the limitation for the levy of the penalty was to be considered from the date of issue of notice and not from the date of assessment order, as the penalty under 271A and 271B are separate penalties and there is no bar on issue of notice under section 271B separately *de hors* the assessment order or notice under section 271A.

(*) The proviso to the section 275(1)(a) provides for time limit of one year from the end of the month in which CIT(A) order is received. Thus, the proviso carves out an exception from the main section in as much as in cases where no appeal is filed before the Tribunal, the AO must impose penalty within a period of one year to be reckoned from the end of the financial year in which the order of the CIT(A) is received by the CIT- However, the said proviso inserted from 1st June, 2003 does not effect the matters which are in Tribunal and the penalty can be levied within six months after the end of the month in which the Tribunal order is received. If the proviso is read in the manner that no penalty can be levied after one year of receipt of the CIT(A) order, then the proviso will obliterate the main section, which would be wrong interpretation of the proviso. [*Rayala Corporation P. Ltd.* 288 ITR 0452 (Mad.), *CIT vs. Mohair Investments and Trading Co.(P) Ltd.* 345 ITR 51 (Del.)]

Original assessment set aside by ITAT or under S. 263 by CIT

Where the assessment is completed and then the said assessment in appeal is set aside. How the time limit in section 275 is to be considered? The time limit is to be considered from the “the proceedings, in the course of which action for the imposition of penalty has been initiated”. Since the original assessment is set aside the penalty notice issued earlier with the original assessment would lapse. [*Ranchodbhai Haribhai Jadhav* (238 ITR 949)] However, if penalty is initiated in the fresh assessment order passed then the time limit would have to be considered from the fresh assessment order passed. [*CIT vs. Mool Chand Behari Lal*(1989)178 ITR 665, *Seetharama Lakshmi Rice & Groundnut Oil Mill Contractors Co. vs. ITO* (1977) 1977 CTR (AP) 244 : (1978) 111 ITR 212 (AP) and *Seth Panchhi Ram & Co. vs. CIT* (1992) 101 CTR (HP)143 : (1991) 192 ITR 289 (HP)]

When the CIT reviews the order of assessment under section 263, and issues amendment of the order or set asides the entire assessment can penalty be levied from the amended order under section 143(3) r.w.s. 263, Can the limitation is to be calculated from the said order of assessment under section 263. The situation has two aspect where the entire assessment is not set aside but only the order is amended on one of the issues. In such a case if the date on which order of penalty is passed beyond the limitation period then can it be said to be valid as the "proceedings in the course of which action for the imposition of penalty has been initiated" would be the original order under section 143(3). Therefore it could be argued that the penalty order is time barred. However where the entire order is set aside by the CIT it would not be correct to argue the above and the judgment in the case of *CIT vs. Mool Chand Behari Lal* (supra) would be directly applicable and penalty would be held to be valid.

"Proceedings, in the course of which action for the imposition of penalty has been initiated"

The above term means the proceedings in which it was identified that there is a violation as per the law leading to penalty by the assessee. In the case of *CIT vs. M A Prestressed Works* 220 ITR 226 the order of assessment was passed on 30th July, 1983, which was subjected to appeal and the appeal was dismissed on 24th February, 1984. The penalty was levied on 24th March, 1988 well beyond the time of limitation. It was contended by the department that the penalty was levied within the limitation period which is to be calculated from the order of cancellation of firm registration. The argument was rejected by the court. Thus in a similar situation, when a rectification order is passed either enhancing or reducing the liability. Can it be said that the limitation for levy of penalty should be calculated from the date of section 154 order? The answer seems to be no based on the above judgment in *CIT vs. M A Prestressed* (supra).

Appeal filed not admitted

In the case of *Deewan Engineering Works vs. CIT 319 ITR 375* there was an interesting issue where the assessee filed an appeal to the ITAT which was late. The assessee wrote to the ITO to keep the penalty in abeyance till the decision of the ITAT. The ITAT did not admit the appeal and the same was rejected. In the penalty proceedings the assessee contended that the penalty was not admitted and hence since there was no appeal filed the penalty was time barred. The court held that that though the appeal was not admitted the same was an appeal and hence the penalty was not time barred, further it held that the assessee could not be allowed to take advantage of its own wrong.

Penalties under sections 271D/271E and applicability of clause (c)

Penalties covered in the last category cover cases not covered by the first two clauses. The assessee has not initiated appeal nor any revision is initiated. Here the penalty is to be levied within the end of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated or six months from the end of the month in which action for imposition of penalty is initiated whichever is later. The issue was considered by the Bombay High Court in the case of *CIT vs. Chhajer Packaging and Plastics P Ltd.* 300 ITR 180. In this case the penalty under section 271D arose in the course of order dated 30th March, 1999. The penalty notice was issued on the 6th April, 1999. The penalty was levied on 13th March, 2000. It was held that the penalty could have been levied within six months from the end of month in which penalty were initiated that is 29th October, 1999 and therefore the penalty was time barred.

An interesting issue was taken up before the Rajasthan High Court. In the case of assessee assessment was completed under section 143(3) on 25-3-2003. The Assessing Officer noticed that the assessee had taken a cash loan

in violation of section 269SS to the tune of ₹ 4,00,000/-. He therefore issued a notice under section 271D which was served on the assessee on 27-3-2003. The matter was then referred to the Joint Commissioner on 22-3-2004 and the Joint Commissioner issued a show cause notice thereafter and passed an order on 28-5-2004.

The assessee filed appeal before the CIT(A) and the penalty levied was deleted as being time barred. The department appeal to the ITAT was also dismissed and the matter therefore came up before the High Court.

In the High Court it was argued by the department that the AO was not competent to issue a notice and hence the time barring should be considered only from the date of issue of notice by the Joint Commissioner. It was further argued that the assessment 143(3) was appealed against by the assessee and the CIT(A) order was received on 13-2-2004 and therefore section 275(1)(a) is applicable and not 275(1)(c).

Both the contentions were rejected by the court. The court held that the penalty under 271D and 271E has nothing to do with the assessment order and therefore 275(1)(c) would apply. (following *CIT vs. Hissaria Bros.*, (2007) 291 ITR

244 (*Raj.*). The court further also rejected the contention that the notice issued was not valid and hence should be considered from notice issued by the Jt. CIT. It held that the order should have been passed by 30th September, 2003 and since it was not done the order levying penalty was time barred. [Jitendra Singh Rathore 352 ITR 327 (*Raj.*)]

Section 275(1A) effect of an order in appeal on the penalty order

The section introduced from 13-7-2013, provides that if the assessee is in appeal and the penalty order has been already passed, then on the receipt of the appeal order either from the CIT(A)/ ITAT/ High Court/ Supreme Court the AO shall within six months from the receipt of the order by the Pr. CCIT or CCIT or Pr. CIT or CIT (or within six months of passing of order under sections 263/264), pass an order giving effect of the order on the penalty order which is already passed.

The assessee will have to give an opportunity of being heard to the assessee and the provisions of 274(2) which provides for monetary limit for the levy of penalty only with the permission of the Joint Commissioner would apply to such order under section 275(1A).



To succeed, you must have tremendous perseverance, tremendous will. I will drink the ocean," says the persevering soul, "at my will mountains will crumble up." Have that sort of energy, that sort of will, work hard, and you will reach the goal.

— Swami Vivekananda



CA Vyomesh Pathak*

Penalty for violation of TDS / TCS Provisions

Background

The Income-tax Act, 1961 ('the Act') contains various provisions requiring a person responsible for making certain payments, to deduct tax at source before making the payment to the payee. This mode of collection of income tax is called Tax Deduction at Source ('TDS'). Chapter XVII-B of the Act deals with the provisions of TDS. Further, Chapter XVII-BB of the Act deals with the provisions of Collection of Tax at Source ('TCS').

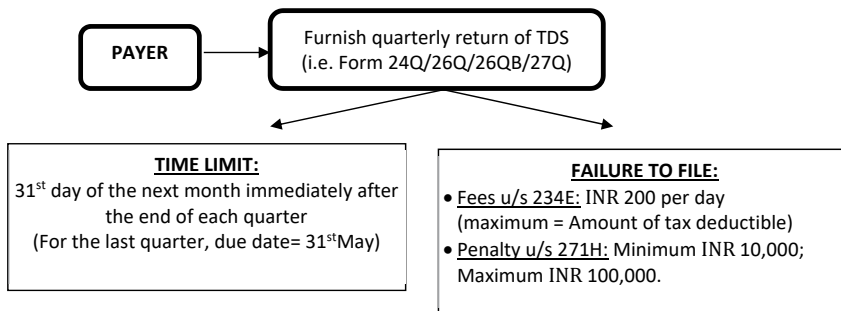
TDS and TCS has become one of the major recurring and regular source of collection of tax by the Indian Income-tax Authorities. TDS/ TCS compliance is also one of the major and critical ongoing compliances under the Act. Central Board of Direct Taxes ('CBDT') also has recently enhanced the focus on TDS / TCS collections. Indian Tax Authorities have also resorted to

measures like TDS surveys to ensure proper compliance in this regard. In fact, in certain cases of defaults, apart from the levy of interest and penalty for default in TDS/TCS compliances, the tax authorities have also initiated the prosecution proceedings against those persons responsible for undertaking TDS/ TCS compliances.

Therefore, it is very relevant and crucial for all the persons responsible for TDS/ TCS that they comply with the provisions appropriately in order to overcome the interest and penal consequences.

Consequences of non-compliance of TDS/TCS Provisions

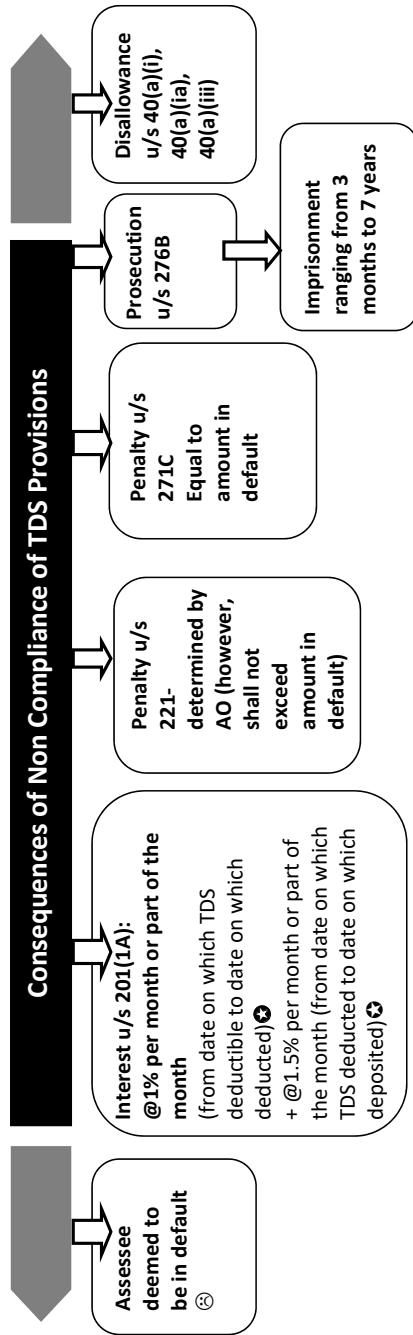
Before we go on to deliberate on the penalty provisions for TDS/ TCS non-compliance, appended below is a snapshot of the consequences of non-compliance of TDS/ TCS provisions for ease of reference –



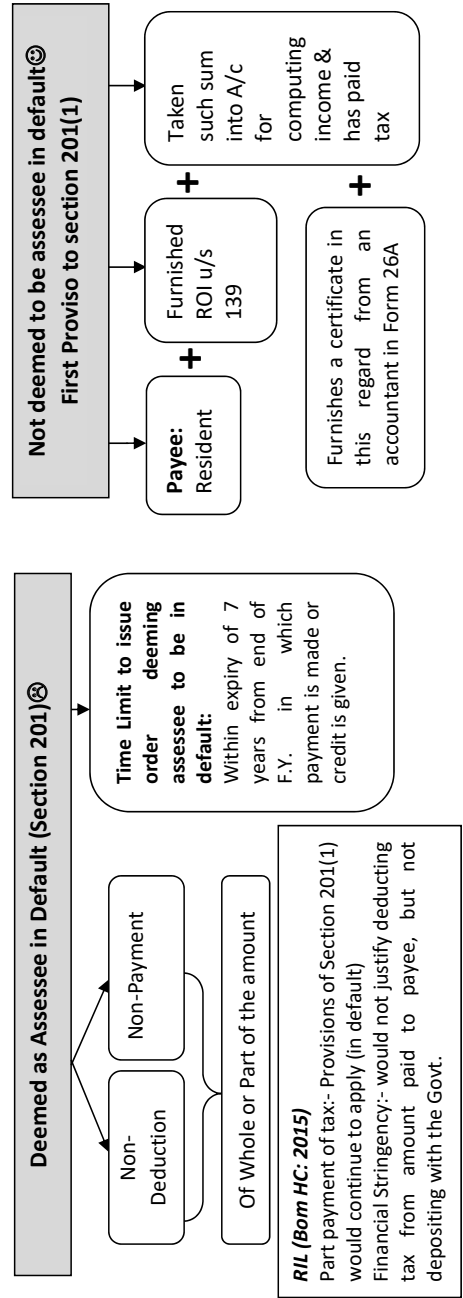
* The Author would like to acknowledge the support provided by CA Shefali Malhotra in contributing this article

Section	Nature of Default	Penalty
272A(2)	Failure to issue TDS certificates Failure to deliver declaration in Form 15G/15H u/s. 197A Failure to deduct and pay tax as required u/s. 226(2)	INR 100 per day during which the failure continues Maximum penalty = Tax deductible

Note: Penalty shall not be levied u/s. 221, if the AO is satisfied that failure to deduct and pay tax is on good and sufficient reasons.



❖ If a person fails to deduct TDS from payment made/ credited to RESIDENT PAYEE AND such person is not deemed as assessee in default, then interest only till date of filing ROI by RESIDENT PAYEE



1. Disallowance of expenditure

As per section 40(a)(i) of the Act, any sum (other than salary) payable outside India or to a non-resident, which is chargeable to tax in India in the hands of the recipient, shall not be allowed to be deducted if it is paid without deduction of tax at source or if tax is deducted but is not deposited with the Central Government till the due date of filing of return.

Similarly, as per section 40(a)(ia) of the Act, any sum payable to a resident, which is subject to TDS, would attract disallowance to the tune of 30 per cent of the sum payable, in case of default in deduction of tax at source or if tax is deducted but is not deposited with the Central Government till the due date of filing of return as specified in Section 139(1) of the Act.

However, where in respect of any such sum, tax is deducted or deposited in any subsequent year, as the case may be, the expenditure so disallowed shall be allowed as deduction in that year.

2. Levy of interest under section 201(1A) of the Act

If a person fails to deduct the whole or any part of the tax at source, or, after deducting, fails to pay the whole or any part of the tax to the credit of the Central Government within the prescribed time, the provisions of section 201 shall get triggered and the said person shall be deemed to be an assessee in default in respect of such tax and be liable for penalty under section 221 of the Act.

Further, section 201(1A) of the Act lays down that such person shall be liable to pay simple interest:

- (i) at one per cent for every month or part of the month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted; and

- (ii) at one and one-half per cent for every month or part of a month on the amount of such tax from the date on which such tax was deducted to the date on which such tax is actually paid.

Having said the above, the person shall not be deemed to be an assessee in default, in case where the resident payee has:

- filed his Return of Income ('RoI') under section 139 of the Act;
- has taken into account such sum for computing income in his RoI;
- has paid tax on income declared by him in such RoI; and
- furnishes a certificate in this regard from an accountant in Form 26A.

Apart from the above consequences of disallowance and interest, there are also penal consequences for default in TDS/TCS compliances.

The penal consequences can be bifurcated into two baskets:

- (a) Penalty for non-deduction or non-collection of tax at source or for default in deposit of tax so deducted or collected; and
- (b) Penalty / Fees for delay or default in furnishing statements or TDS Returns.

The said penal consequences are discussed in the subsequent paragraphs.

I. Penalty for non-deduction or non-collection of tax at source or for default in deposit of tax so deducted or collected to the credit of the Central Government

A. Levy of Penalty under section 271C of the Act for default in TDS compliance under Chapter XVII-B

If any person fails to deduct or pay the whole or any part of the tax as required by or under the provisions of Chapter XVII-B of the Act, then such person shall be liable to pay penalty of **an amount equal to tax not deducted or paid** as the case may be, under section 271C of the Act. The total amount of penalty shall not exceed the amount of tax in arrears.

The penalty under section 271C of the Act shall be imposed by the Joint Commissioner of Income-tax. Further, the levy of penalty under section 271C of the Act shall be subject to the provisions of section 273B of the Act which provides that penalty under section 271C shall not be levied if the person proves that there was a reasonable cause for the said failure.

The provisions of section 273B of the Act are discussed in the subsequent paras.

B. Levy of Penalty under section 271CA of the Act for default in TDS compliance under Chapter XVII-BB

If any person fails to collect the whole or any part of the tax as required by or under the provisions of Chapter XVII-BB of the Act, then, such person shall be liable to pay a **sum equal to the amount of tax which such person failed to collect**.

The penalty under section 271CA of the Act shall be imposed by the Joint Commissioner of Income-tax. Further, the levy of penalty under section 271CA of the Act shall be subject to the provisions of section 273B of the Act which provides that penalty under section 271CA shall not be levied if the person proves that there was a reasonable cause for the said failure.

The provisions of section 273B of the Act are discussed in the subsequent paras.

II. Penalty / fees for delay or default in furnishing statements or TDS returns

Delay or default in furnishing Statements or TDS Returns may have the following consequences;

- A. Fees for late filing of TDS/TCS Returns leviable under section 234E of the Act;
- B. Penalty for late filing or Non-filing of TDS/ TCS statements under section 271H of the Act; and
- C. Penalty for failure to furnish returns, statements etc. under section 272A(2)(c), (f) to (m) of the Act

A. Fees for late filing of TDS/ TCS Returns leviable under section 234E of the Act

The Finance Act, 2012 introduced the section 234E in order to levy fees for late filing of TDS/ TCS Returns.

According to the provisions of section 234E of the Act, where a person fails to deliver or cause to be delivered a statement within the time prescribed in section 200(3)/206C(3), then he shall be liable to pay, by way of fee, **a sum of INR 200 for every day** during which the failure continues.

The amount of late fees shall not exceed the amount of TDS. Further, as per section 234E(3) of the Act, the late filing fees is required to be paid before filing the TDS return.

As per section 234E(4), the provisions of this section shall apply to the TDS/ TCS Returns to be filed on or after 1st day of July, 2012.

It is worth noting that INR 200 per day is not a penalty but is fees for late filing.

• Constitutional Validity of Section 234E of the Act

The Constitutional validity of section 234E was challenged before various courts, whereby it was argued that the provisions of section 234E is *ultra vires*. The argument on behalf of the assessee challenging the constitutional validity of section 234E were that under section 234E, late fees has been made mandatory and this was argued to be unreasonable and violative of Article 14 of the Constitution of India. As

there can be genuine difficulty in uploading the TDS Statement within the prescribed time and therefore imposing fee for delayed filing without being heard clearly amounts to arbitrariness.

However, various High Courts¹ have upheld the Constitutional Validity of section 234E of the Act.

The **Bombay High Court**, in the case of *Rashmikant Kundalia vs. Union of India* [2015] 54 *taxmann.com* 200, while upholding the Constitutional validity has rejected the argument of the petitioner that a 'fee' is known in the commercial and legal world to be recompense of some service or some special service performed, and it cannot be collected for any dis-service or default. The High Court further held that late filing of TDS returns by deductor causes inconvenience to everyone and section 234E levies a fee to regularize said late filing and is not in guise of a tax nor is it onerous.

- **Levy of Fees prior to 1 June 2015**

Another question that arises that though the provisions of section 234E were introduced by Finance Act, 2012; there was no enabling provision therein for raising demand in respect of levy of fees under section 234E of the Act. Therefore in such a scenario, whether fees can be levied under section 234E prior to 1 June 2015.

It was only by virtue of Finance Act, 2015 that an amendment was brought in section 200A of the Act which effectively enables the levy of fees with prospective effect from 1 June 2015. Therefore, in effect, it can be argued that it is only post 1 June 2015 that in the course of processing of a TDS statement and issuance of

intimation under section 200A of the Act, an adjustment could also be made in respect of the fee, if any, shall be computed in accordance with the provisions of s. 234E.

Reliance in this regard can be placed on the judgment of the **Amritsar Bench of Income-tax Appellate Tribunal ('ITAT')** in the case of *Sibia Healthcare (P.) Ltd. vs. DCIT* [2015] 61 *Taxmann.com* 70.

Further, the Karnataka High Court in the case of *Fatheraj Singhvi vs. Union of India* [2016] 73 *Taxmann.com* 252 has also held that section 200A enabling Assessing Officer to determine the fee under section 234E is brought about with effect from 1-6-2015 and was held to be prospective, hence, no computation of fee for demand or intimation for fee under section 234E could be made for TDS deducted for respective assessment year prior to 1 June 2015.

Having said the above, it is worth noting that the **Gujarat High Court** has taken a converse view in this regard in the case of *Rajesh Kourani vs. Union of India* [2017] 83 *taxmann.com* 137 wherein the High Court has held that section 234E of the Act is a charging section and section 200A is merely a machinery provision. When section 234E has already created a charge for levying fee that would thereafter not be necessary to have yet another provision creating the same charge. Viewing section 200A as creating a new charge would bring about a dichotomy. Even in absence of section 200A of the Act with introduction of section 234E, it was always open for the Revenue to demand and collect fee for late filing of the statements.

Also, the Rajasthan High Court, while upholding the constitutional validity of section 234E of the Act in the case of *Dundlod Shikshan Sansthan vs. Union of India* [2015] 63 *taxmann.com*

¹ *Rashmikant Kundalia vs. Union of India* [2015] 54 *taxmann.com* 200 (Bombay);
Dr. Amrit Lal Mangal vs. Union of India [2015] 62 *taxmann.com* 310 (Punjab & Haryana);
Dundlod Shikshan Sansthan vs. Union of India [2015] 63 *taxmann.com* 243 (Rajasthan);
Sree Narayana Guru Smaraka Sangam Upper Primary School vs. Union of India [2017] 77 *taxmann.com* 244 (Ker.);
Lakshminirman Bangalore (P.) Ltd. vs. DCIT [2015] 60 *taxmann.com* 144 (Karnataka)

243, has held that even prior to the amendment to Section 200A by Finance Act with effect from 1 June 2015, imposition of fees under section 234E of the Act cannot be said to be illegal.

Therefore, in effect, there are contradicting judgments on the said issue – two in favour of the Tax Authorities and one in favour of the assessee. For assessees of Gujarat and Rajasthan, their respective High Court rulings will be binding. Whereas the assessees of Karnataka can rely on the jurisdictional High Court for non-applicability of section 234E prior to 1st June 2015.

For assessees of other States, in view of contradicting judgments on both sides, they may rely on the favourable judgment of the Karnataka High Court in absence of any negative ruling from the Supreme Court.

B. Penalty for late filing or Non-filing of TDS/ TCS statements (returns) under section 271H of the Act

When a person fails to file TDS/TCS returns on or before the due dates prescribed in this regard or files incorrect TDS/TCS return, then the Assessing Officer may direct such person to pay penalty under section 271H.

The quantum of penalty under section 271H is as under –

- Minimum Penalty that can be levied – INR 10,000
- Maximum Penalty that can be levied – INR 100,000

Penalty under section 271H will be in addition to late filing fees prescribed under section 234E.

The above section was inserted by Finance Act, 2012 and has come into effect from 1st day of July, 2012.

No penalty will be levied under section 271H for the failure to file the TDS return if following conditions are satisfied:

- The tax deducted/collected at source is paid to the credit of the Government;
- Late filing fees and interest (if any) is paid to the credit of the Government; and
- The TDS return is filed before the expiry of a period of one year from the due date specified in this behalf.

It should be noted that the above relaxation is applicable only in case of penalty levied under section 271H for delay in filing the TDS/TCS return and not in the case of filing incorrect TDS/TCS statement.

Apart from the above relaxation, in following two cases the taxpayer can get relief from penalty under section 271H of the Act:

- Under section 273A(4) the Principal Commissioner of Income-tax or Commissioner of Income-tax has power to waive or reduce the penalty levied under the Income-tax Act. Penalty can be waived or reduced by the Principal Commissioner or Commissioner as the case may be, if the conditions specified in section 273A(4) in this regard are satisfied i.e. if he is satisfied-
 - that it would cause genuine hardship to the assessee; and
 - that the assessee has co-operated in any inquiry relating to the assessment or proceeding.
- Apart from shelter of section 273A(4), section 273B also provides immunity from penalty in genuine cases. As per section 273B, penalty under section 271H will not be levied if the taxpayer proves that there was a reasonable cause for failure. The provisions of section 273B are discussed hereunder.

C. Penalty for failure to furnish returns, statements etc. under sections 272A(2)(c), (f) to (m) of the Act

The relevant provisions of section 272A(2) of the Act are summarised in the below table-

Section	Nature or Default	Penalty
272A(2)	Failure to issue TDS certificates	INR 100 per day during which the failure continues. Maximum penalty = Tax deductible
	Failure to deliver declaration in Forms 15G/15H u/s 197A	
	Failure to deduct and pay tax as required u/s. 226(2)	

Further, the levy of penalty under section 272A(2) of the Act shall be subject to the provisions of section 273B of the Act which provides that penalty under section 272A(2) shall not be levied if the person proves that there was a reasonable cause for the said failure.

The provisions of section 273B of the Act are discussed in the subsequent paras.

Penalty not to be imposed if the assessee proves Reasonable Cause – Section 273B

As mentioned above, the levy of penalty under sections 271C, 271CA, 271H and 272A(2) of the Act shall be subject to the provisions of section 273B of the Act.

Section 273B of the Act provides that penalties under above sections shall not be imposable on the person or assessee as the case may be, for any failure referred to in the said provisions if he proves that there was **reasonable cause** for the said failure.

The term **reasonable cause** has not been defined under the Act. However, various courts have interpreted the same over a period of time which is summarised hereunder–

Sr. No.	Judicial Precedent	Interpretation of 'Reasonable Cause'
1	<i>Azadi Bachao Andolan vs. Union of India</i> [2001] 252 ITR 471 (Delhi)	<ul style="list-style-type: none"> Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of <i>bona fides</i>.
2	<i>CIT vs. Triumph International Finance (I) Ltd.</i> [2012] 345 ITR 270 (Bom.)	<ul style="list-style-type: none"> The expression 'reasonable cause' would have wider connotation than the expression 'sufficient cause'. The expression 'reasonable cause' in section 273B for non-imposition of penalty under section 271E is to be construed liberally depending upon the facts of each case.

Sr. No.	Judicial Precedent	Interpretation of 'Reasonable Cause'
3	<i>Woodward Governors India (P.) Ltd. vs. CIT [2001] 118 Taxman 433 (Delhi)</i>	<ul style="list-style-type: none"> • 'Reasonable cause' as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. • It can be described as a probable cause. • It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably
		lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.
4	<i>Dillu Cine Enterprises (P) Ltd. vs. Addl. CIT [2002] 80 ITD 484 (Hyd. – Trib.)</i>	<ul style="list-style-type: none"> • The expression 'reasonable cause' has to be considered pragmatically and an open transaction done to meet exigencies of business, could be said to have constituted 'reasonable cause'.
5	<i>Jt. CIT vs. Dainik Assam (P) Ltd. [2004] 3 SOT 542 (Gau. – Trib.)</i>	<ul style="list-style-type: none"> • in the context of the penalty provisions, the words 'reasonable cause' would mean a cause which is beyond the control of the assessee. • 'Reasonable cause' obviously means a cause which prevents a reasonable man of ordinary prudence acting under normal circumstances, without negligence or inaction or want of <i>bona fides</i>, from furnishing the return in time.

Therefore, while reference can be drawn to the above judicial precedents for the interpretation of the term reasonable cause, it is pertinent to note that the onus will be on the assessee to prove the reasonable cause in each case based on the facts and circumstances involved therein.

Having said the above, no order imposing penalty shall be passed by any Income-tax Authority, unless the person on whom the penalty is proposed to be imposed is given an opportunity of being heard in the matter by such Authority.

Conclusion

TDS/ TCS compliance though routine is very crucial as any non-compliance in this regard will have severe consequences such as disallowance of expenses, levy of interest, levy of fees for delay in filing, penalty for default. Therefore, it is relevant to understand the repercussions of non-compliance of the TDS/ TCS compliances including the penal consequences as discussed above and thereby ensure timely compliance. Further non-payment or late payment TDS may also attract prosecution.

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Paras S. Savla & Harsh R. Shah, *Advocates*

Other Penalties

1. Introduction

The Government under the leadership of Prime Minister Shri Narendra Modi had taken stringent measures in order to curb the black money and to streamline it into mainstream economy. First measure was to bring the big ones in the tax net, who had black money stashed abroad and hence the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ('BMA') being introduced. Thereafter the Government brought the Income Disclosure Scheme, 2016 ('IDS'). IDS provided domestic taxpayers a window to declare their undisclosed income or income represented in the form of any asset. The last step was a clean sweep by way of demonetisation ('DM'), which forced everyone to account for their cash. Along with demonetisation, Government passed the Taxation Laws (Second Amendment) Act, 2016 *inter alia* introducing the Pradhan Mantri Garib Kalyan Yojana, 2016 ('PMGKY') as an escape route for the last leg of people who were forced into being Income-tax compliant.

One would have also noticed that Budget 2016-17 had an amendment with respect to penalty, which would change the entire penalty dynamics. Section 271, which in a manner of speaking, was discretionary in nature was sought to be replaced with Section 270A which is more clear, since it is a formula based approach. We understand penalties u/s. 270A, 271 are dealt

in separate chapters, and hence we will restrict ourselves to the penalties assigned to us i.e. under sections 271AAC, 271DA and 271J.

2. Section 271AAC – Penalties in respect of certain income

While there were various measures to curb black money, this also provided a planning opportunity with respect to coming clean on black money apart from the schemes introduced by the Government.

2.1. Provisions of Income-tax Act to counter black money

Income-tax Act has inbuilt mechanism to tax black money also. Sections 68, 69, 69A, 69B and 69C are all deeming provisions. They cast an onus on the assessee to offer a satisfactory explanation, failing which the Assessing Officer would deem the amounts as income, since its source may be assessee's black income. Each of these sections deal with different items as under:

1. Section 68 deals with credits found in the books of the assessee. There are times where the assessee is in need of funds and it introduces its own black income in the books of account maintained by him by way of a credit entry, under the garb of a loan from third party or share premium etc. Section 68 empowers the Assessing

Officer to deem such credits as income of the assessee unless the assessee provides satisfactory explanation for the credit entries.

2. Section 69 deals with investments made by an assessee but not recorded in the books of account. This section casts the onus on an assessee to provide a satisfactory explanation, failing which such investments would be deemed as income of the assessee.
3. Section 69A deals with situations where an assessee is found to be an owner of any money, bullion, jewelry or other valuable article which are not recorded in the books of account. This section casts the onus on an assessee to provide a satisfactory explanation, failing which such money would be deemed as income of the assessee.
4. Section 69B deals with situations where the above items are recorded in the books of account maintained by the assessee but actual value of making such items exceeds

the amount so recorded. This section casts the onus on an assessee to provide a satisfactory explanation with respect to the excess, failing which such money would be deemed as income of the assessee.

5. Section 69C deals with expenditure incurred by an assessee for which no explanation is provided by the assessee. This section casts the onus on an assessee to provide a satisfactory explanation, failing which such money would be deemed as income of the assessee.
6. Section 69D deals with deeming the amounts, which are either borrowed or repaid on a hundi otherwise than by way of an account payee cheque drawn on a bank, as income of the Assessee. However, it provides that once an amount is added on it being borrowed, it cannot be added once again when it is being repaid.

In spite of above sections within Income-tax Act need for some series of surgical strike was needed to the growing black economy, and hence various laws were passed / amended.

2.2 Time lines and Tax rates

↓	May, 2015	Black Money Act, passed
	February, 2016	Budget 2016-17 introduced along with Income Disclosure Scheme
		(Planning period – in terms of rate of tax)
	November, 2016	Demonetisation declared
	December, 2016	Taxation Laws Second Amendment Act
April, 2017	Start of AY 2017-18	

The effective rate under BMA was 60% and under IDS was 45%. However, consider a situation wherein an assessee itself declares its black income under Sections 68, 69, 69A, 69B, 69C or 69D and offers it to tax in the return of income, accordingly based on the existing provisions of section 115BBE income offered under these sections would be taxed at the rate of 30%. Further there would be no penalty as per section 270A since there would be no under reporting of income. Hence, the effective tax rate would be only 30%, which would be much lesser than the rates in the IDS and PMGKY. This can be demonstrated by the following chart :

Declaration Scheme	Suo motu declared by Assessee			Not declared by Assessee – but assessed and taxed by the Tax Officer
	Tax + Surcharge	Penalty	Effective rate	Effect rate
BMA	30% + 0%	100%	60%	Tax of 30% and penalty of three times the tax amount on the undisclosed foreign asset or income. Effective rate is 120%.
IDS	30.0% + 7.5%	25%	45%	If income is declared under sections 68, 69, 69A, 69B, 69C or 69D then as per sections 115BBE tax levy is of 30% + applicable surcharge. As per section 270A, since amount as per return would remain same as amount assessed, no penalty for under reporting of income would be levied. Thus effective tax rate is only 30% + applicable surcharge.
PMGKY	30% + 10%	10%	50%	

This lacuna had to be filled; otherwise PMGKY would have been an utter failure. Hence, the Taxation Laws (Second Amendment) Act, 2016 brought in certain remedial amendments:

1. Section 115BBE was amended with two major changes:
 - a. Section itself provided for both situations, i.e. income offered by Assessee itself under sections 68, 69, 69A, 69B, 69C or 69D and income assessed by Tax Officer under sections 68, 69, 69A, 69B, 69C or 69D; and
 - b. Rate of tax was changed from 30% to 60%.
2. Section 271AAC was added providing for 10% penalty on the income enhanced by the Tax Officer under sections 68, 69, 69A, 69B, 69C or 69D. It was expressly provided that if the Assessee itself offered income to tax under sections 68, 69, 69A, 69B, 69C or 69D, no penalty was to be levied. Penalty under section 270A was not to be levied under any of the two circumstances.

Post the above amendments, the taxation rates as compared to IDS and PMGKY stood as under:

Declaration Scheme	Tax + Surcharge	Penalty	Effective rate	Normal provisions – if unearthed by tax officer
IDS	30.0% + 7.5%	25%	45%	If income is declared under sections 68, 69, 69A, 69B, 69C or 69D then as per section 115BBE tax levy is of 60% + surcharge of 25% that equals to 75%. Penalty under section 271AAC of 10% if Assessee does not offer the income in return of income and the tax officer assesses it in the order. Thus effective tax rate is 81%.
PMGKY	30% + 10%	10%	50%	

Hence, the objective of the introducing penalty under section 271AAC along with section 115BBE was for rationalising the existing provisions, for ensuring success PMGKY scheme and making that people who did not avail the benefit of IDS faced the wrath of law.

2.3 Penalty u/s. 271AAC

The Tax Officer may levy a penalty of 10% of the tax amount under 115BBE if income of Assessee includes any income referred to in Sections 68, 69, 69A, 69B, 69C and 69D. An exception is carved out where no penalty would be levied, which is when an Assessee itself offers income under these provisions under the return filed as per section 139 and tax as per 115BBE has been paid on or before the end of the relevant previous year.

Further, it is expressly provided that, no penalty under section 270A shall be levied. Procedure for levy of penalty would be as per section 274 and the limitation would be as per section 275.

3. Section 271DA – Penalty for failure to comply with the provision of section 269ST

Demonetisation was a drastic measure adopted by the Government in its efforts to bring the black money economy under the main stream economy. However, drastic measures were also required to be taken from preventing the black money economy to develop again.

3.1 Section 269ST

With a view to promote digital economy and create a disincentive against cash economy, a new section 269ST has been inserted in the Income-tax Act, 1961 (the Act) *vide* Finance Act, 2017. Section 269ST is one such measure aimed to stem the growth of the black money economy.

The said section *inter alia* prohibits receipt of an amount of two lakh rupees or more by a person, in the circumstances specified therein, through modes other than by way of an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account.

The limit of two lakh or more is applicable to amounts receivable ;

1. in aggregate from a person in a day or
2. in respect of a single transaction or
3. in respect of transactions relating to one event or occasion from a person

The said section excludes receipt by

- a) Government
- b) Any banking company; post office savings bank or co-operative bank;
- c) Any corporation established by Central, State or provincial Act,
- d) Government company
- e) Such other persons or class or persons or receipts, which Central Government may notified u/s. 269S and which Government may specifically notify for this section.

3.2 Non-compliance of section 269ST – Penalty u/s. 271DA

Non-compliance attracts a penalty of a sum equal to the amount of such receipt. Interestingly penalty is not on the amount in excess of 2,00,000 but the entire amount of the receipt.

However, if such person proves that there were good and sufficient reasons for the contravention then no penalty shall be levied.

Penalty has to be imposed by the Joint Commissioner.

3.3 Issues in 269ST and levy of penalty u/s 271DA

Section 269ST entails three situations.

The first situation being aggregate amount received from a person in a day, is quite clear.

One issue that may arise for second situation as the term 'single transaction' is neither defined nor explained. Say for example, a person is employed for a monthly salary of 17,000. The individual payments won't violate provisions of 269ST but if aggregated for a year, on application of the 'a single transaction', the salary of 2,04,000 would violate 269ST. Similar situation could also arise in case of repayment of loan to a Non-banking Financial Company (NBFC) or Housing Finance Company (HFC).

The CBDT on 3rd July, 2017 *vide* Circular No. 22 of 2017 has it is clarified that in respect of receipt in the nature of repayment of loan by NBFCs or HFCs, the receipt of one instalment of loan repayment in respect of a loan shall constitute a

‘single transaction’ as specified in clause (b) of section 269ST of the Act and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions under section 269ST. One may extend the clarification provided by the circular to all similar situations.

The third situation also looks explicit, that a person shall not receive from another a sum above ₹ 2,00,000 in cash in respect of one event or occasion. Though this seems to be a repetition since the first condition ought to cover this, but the objective may be to clearly provide for informal payments like gifts at wedding, birth etc. First situation restricts per day transactions whereas third situation restricts per event/occasion transactions.

One issue that may arise is when transactions are a result of barter trade. There may also be situations where settlement are done through journal entries. The Bombay High Court in case of *Triump International [2012] 345 ITR 270 (Bom)* had held that settlement through journal entries amounts to contravention of section 269T. This decision would also be applicable for section 269ST, and hence this section may be counterproductive for business transactions and to freely conduct trade.

Provisions of section 269ST were also capable of prohibiting cash withdrawal from one’s own bank account above ₹ 2,00,000. Hence *vide* notification dated 5th April 2017 [Notification S.O. 1057(E)], it has been clarified that section 269ST shall not apply to receipt by any person from any banking company, post office savings bank or co-operative bank.

Vide notification dated 3rd July 2017 (Notification S.O. 2065(E)) certain peculiar transactions of the banking industry are also exempted from the provisions of section 269ST.

Vide circular dated 3rd November 2017 (Circular No. 27 of 2017) the CBDT has clarified that cash sales above 2,00,000 by a cultivator of agricultural produce is prohibited by section 269ST.

The biggest issue is whether ‘Common Sense’ will be good and sufficient reasons for contravening provisions of section 269ST for non-levy of penalty. It is ‘Common Sense’ in business, not to refuse payment, since one never knows if the same

person would be able to make the payment on a later date.

Though penalty would not be leviable whether the assessee proves reasonable cause, the question as to what amounts “reasonable cause” has to be tested in each and every case.

4. Section 271J - Penalty for furnishing incorrect information in reports or certificates.

4.1 Section 271J

In its enthusiasm to increase voluntary tax compliance by the citizens of India Government has various schemes for the citizens to be tax compliant. Tax laws also require certification of various reports and certificates by a qualified professionals to ensure that the information furnished by an assessee is appropriately filtered to maintain its relevancy and correctness. Though the professional furnishing the report or certificate undertakes due diligence before making such certification, it has been noticed since few years that there has been a lot questioning on professional creditability. It seems that the Government feels that professionals are watchdogs and should be the whistleblowers before major scam arises.

While there are various provisions under the Act that penalise the defaulting assessee in case of furnishing incorrect information, there is no penal action taken on the professional certifying/reporting such incorrect information. Hence section 271J was introduced w.e.f. 1-4-2017 to penalise the professionals. Furnishing of incorrect information in any report or certificate furnished under any provision of this Act or the rules made thereunder, by an accountant or a merchant banker or a registered valuer is made punishable by a penalty of ₹ 10,000 for each such report or certificate. Such penalty shall be levied by the Assessing Officer or the Commissioner of Income-tax (Appeals). However, as per section 273B, no penalty shall be imposable for any failure referred to in the above provision if the professional proves that there was reasonable cause for the said failure.

4.2 Issues

The section covers furnishing of incorrect information in any report or certificate. Before we dwell into various issues, let us understand whether usually an accountant furnishes information or only provides an opinion on the information furnished by the Assessee. Section 44AB casts a responsibility on the Assessee to get its accounts audited and furnish particulars, and this has to be signed and verified by an accountant. On a close look at Form 3CA and Form 3CB, one may see that it reads as under:

"In our opinion and to the best of our information and according to explanations given to us, the particulars given in the said Form 3CD are true and correct subject to following observations / qualifications, if any:"

On the plain reading of the above statement, one may argue that the accountant/professional is only providing his opinion as to whether the information is true and correct. The accountant is not *per se* responsible for furnishing any information, but only verifying the information based on his professional opinion. Hence, it can be argued that provisions of section 271J would not apply to the audit conducted as per section 44AB.

However when one dives deeper and details, looking at various clauses in Form 3CD it seems that a professional does not need to form any opinion but simply has to give specific particulars. For example, list of brought forward losses and unabsorbed depreciation, or disallowance u/s. 40A(2). A question arises as to whether merely on account of the wordings of Form 3CA, which starts with "In our opinion", does it *ipso facto* mean that the report is simply an opinion or whether one needs to check each and every clause of the Form 3CD to decide if the accountant provided an opinion or merely furnished information. When a professional has to mention particulars for "Depreciation allowable" wherein calculation has to be furnished in Form 3CD, this requires formation of an opinion based on various factors and is not merely furnishing of particulars, could

it be said that section 271J would not apply to this. There is ambiguity around this which would embroil accountants in unnecessary litigation.

Other situation may arise due to report of a registered valuer is submitted by assessee for their immovable property which is disputed by the AO. Since valuation is a subjective exercise, there will always be a conflict between the valuation by the DVO and that of the registered valuer.

Similarly in case of a report from an accountant is necessary u/s. 92E of the Act, to prove that the international transaction / specified domestic transaction entered into by the assessee is at arm's length. Transfer Pricing itself is another subjective area where the arm's length price is determined by adopting any of the prescribed methods. Furthermore, the CBDT had introduced the sixth method of determining the arm's length price, being the "other method". Evidently, the selection of the method as well as the determination of arm's length price is left to the accountant's knowledge and expertise, and any disagreement with the same by the AO, may lead to levy of penalty u/s. 271J.

The Act does not define or explain as to what is incorrect information and thus, the AO and CIT(A) may consider any information, to which they do not agree to, as incorrect information and accordingly levy penalty on the professional. It may lead to a situation that every difference between the return and the assessment order, and which should be mentioned in report/certificate would be treated as furnishing of incorrect information.

Similarly one would have to analyse each and every form so as understand whether one is simply furnishing information or providing an opinion.

Strangely there is no provision for appealing against the levy of penalty and the AO / CIT(A) will have unfettered power to levy such penalty on professionals at their discretion and hence an professional will have file a writ petition and knock the doors of High Court in such situations.

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Viraj Mehta, *Advocate*

Miscellaneous

Section – 271D : Penalty for failure to comply with provisions of Section 269SS

Section 271D of the Income-tax Act, 1961 ('the Act') provides for levy of penalty on a person, if any loan or deposit or specified sum has been taken or accepted by such person in contravention to section 269SS of the Act. Penalty u/s. 271D of the Act will be levied if provisions of Section 269SS of the Act are contravened; thereby let us examine the provisions of Section 269SS and 271D of the Act communally.

Section 269SS of the Act deals with mode of acceptance of loan or deposits or any specified sum. Section 269SS of the Act provides that no person shall take or accept any loan or deposit or any specified sum from any other person otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account,

- a) any amount of loan or deposit or any specified sum or the aggregate amount of loan, deposit and any specified sum; or
- b) on the date of taking or accepting such loan or deposit or specified sum, any loan or deposit or specified sum taken or

accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid; or

- c) The amount or aggregate amount referred to in clauses a and b.

if any of the following amount exceeds ₹ 20,000/- or more.

Thus it is clear that no person can accept any loan or deposit or any specified sum of ₹ 20,000/- or more otherwise than by way of an account payee cheque or an account payee draft or use of electronic clearing system through a bank account. The limit of ₹ 20,000/- will also apply to a case even if on the date of taking or accepting such loan or deposit or any specified sum, any loan or deposit taken or accepted earlier by such person from such depositor is remaining unpaid and such unpaid amount along with the loan or deposit to be accepted, exceeds the aforesaid limit.

This can be explained with an example: If Mr. X has a credit balance of a loan of ₹ 19,000 from Mr. Y. Now in this case Mr. X cannot take loan in excess of ₹ 999 more from Mr. Y except with an account payee cheque or

account payee bank draft or use of electronic clearing system through a bank account.

The provisions of this section shall not apply to any loan or deposit or any specified sum taken or accepted from or any loan or deposit or any specified sum taken or accepted by following:-

- (i) Government
- (ii) Any banking company, post office saving bank or co-operative bank
- (iii) Any corporation established by a Central, State or provincial act
- (iv) Any Government company as defined by Section 2(45) of Companies Act, 2013
- (v) Such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette

Further, the aforesaid provisions of this section shall also not apply to the persons from whom the loan or deposit or specified sum is taken or accepted and the person by whom the loan or deposit or specified sum is taken or accepted, are both having agricultural income and neither of them has any income chargeable to tax under this Act.

The term 'loan or deposit' has been defined as loan or deposit of money and the term 'any specified sum' has been defined as any sum of money receivable, whether as advance or otherwise, in relation to transfer of an immovable property, whether or not the transfer takes place.

The term 'any specified sum' has been introduced by Finance Act, 2015 applicable from 1-6-2015. Post the amendment, seller of the immovable property will be liable to pay penalty under this section if any conditions are violated. Term 'immovable property' is not

defined in this section; recourse may be taken to Transfer of Property Act, 1882. But whether rights in immovable property will also be covered by the provision of this section, is a question of debate. Although the amendment is made in order to curb generation of black money in immovable property transactions, in reality the cash portion of the transaction is not accounted at all and therefore to that extent the amendment will not have the desired effect.

Quantum of Penalty

Penalty leviable u/s. 271D of the Act would be amount of loan or deposit or any specified sum taken or accepted in contravention to section 269SS of the Act.

Approval of Jt. CIT

Sub-section (2) of Section 271D provides that penalty shall be imposed by Joint Commissioner. Joint Commissioner has been defined in section 2(28C) of the Act.

Since, it is mandatory that penalty should be imposed by Joint Commissioner, legality of penalty order u/s. 271D can be challenged if the said is levied by officer lower than Joint Commissioner.

Section – 271E : Penalty for failure to comply with provisions of Section 269T

Section 271E of the Income-tax Act, 1961 ('the Act') provides for levy of penalty on a person, if any loan or deposit or specified advance has been repaid by such person in contravention to section 269T of the Act. Penalty u/s. 271E of the Act will be levied if provisions of Section 269T of the Act are contravened; thereby let us examine the provisions of Section 269T and 271D of the Act communally.

Section 269T of the Act deals with mode of repayment of loan or deposits or any specified advance. Section 269T of the Act provides

that no Branch of a banking company or a co-operative bank and no other company of co-operative society and no firm or other person shall repay any loan or deposit or specified advance received by it otherwise than by an account payee cheque or account payee bank draft in the name of the person who has made the loan or deposit or paid the specified advance or by use of electronic clearing system through a bank account

- a. the amount of the loan or deposit or specified advance together with the interest, if any payable thereon, or
- b. the aggregate amount of the loans or deposits held by such person with the branch of the banking company or co-operative bank or as the case may be the other company or co-operative society or the firm, or other person either in his own name or jointly with any other person on the date of such repayment together with the interest accrued on it, or
- c. aggregate amount of the specified advances received by such person either in his own name or jointly with any other person on the date of such repayment together with the interest, if any, payable on such specified advances,

if any of the following amount exceeds ₹ 20,000/- or more.

Thus it is clear that no person can in his own name or jointly with any other person repay any loan or deposit or any specified advance of ₹ 20,000/- or more otherwise than by way of an account payee cheque or an account payee draft or use of electronic clearing system through a bank account..

This can be explained with an example: If X is having loan of ₹ 30,000 outstanding to Y. Then X cannot repay such loan in cash to Y. In this case, X cannot jointly with other person repay

outstanding to Y of ₹ 20,000 or more other than accepted means of repayment.

It is provided that where the repayment is by a branch of a banking company or co-operative bank then such repayment may/shall also be made by crediting the amount of such loan or deposit to the savings bank account or the current account (if any) with such branch of the person to whom such loan or deposit has to be repaid

The provisions of this section shall not apply to any loan or deposit or any specified advance taken or accepted from:

- (i) Government
- (ii) Any banking company, post office saving bank or co-operative bank
- (iii) Any corporation established by a Central, State or Provincial Act
- (iv) Any Government company as defined by Section 617 of Companies Act, 2013
- (v) Such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette

Further, there is no provision in Section 269T of the Act for non-applicability of this section if both the parties are having agriculture income.

The term 'loan or deposit' has been defined as means any loan or deposit of money which is repayable after notice or repayable after a period and, in the case of a person other than a company, includes loan or deposit of any nature (it is different from meaning as provided in section 269SS) and the term 'any specified advance' has been defined as any sum of money in the nature of advance, by whatever name called, in relation to transfer

of an immovable property, whether or not the transfer takes place.

The term 'any specified advance' has been introduced by Finance Act, 2015 applicable from 1-6-2015. Post the amendment, seller of the immovable property will be liable to pay penalty under this section if any conditions are violated. Term 'immovable property' is not defined in this section; recourse may be taken to Transfer of Property Act, 1882. But whether rights in immovable property will also be covered by the provision of this section, is a question of debate as stated earlier. Similarly, although the amendment is made in order to curb generation of black money in immovable property transactions, in reality the cash portion of the transaction is not accounted at all and therefore to that extent the amendment will not have the desired effect.

Quantum of Penalty

Penalty leviable u/s. 271E of the Act would be amount of loan or deposit or any specified advance repaid in contravention to section 269T of the Act.

Approval of Jt. CIT

Sub-section (2) of Section 271E provides that penalty shall be imposed by Joint Commissioner. Joint Commissioner has been defined in section 2(28C) of the Act.

Since, it is mandatory that penalty should be imposed by Joint Commissioner, legality of penalty order u/s. 271E can be challenged if the said is levied by officer lower than Joint Commissioner.

Issues in Section 269SS r.w.s. 271D and 269T r.w.s. 271E

1. *Whether the provisions of above section apply to payments or receipt by way of journal entries.?*

Provisions of sections 269SS and 269T are not applicable in case where there are journal entries and payment was ultimately paid through account payee cheque. *Commissioner of Income-Tax vs. Noida Toll Bridge Co. Ltd. (2003) 184 CTR Del 266*. Further acknowledgement of debt by the assessee company by passing a journal entry in the books of account would not come within the ambit of the words "loans or deposits of money" as mentioned in Section 269 SS, *Sunflower Builders Pvt. Ltd. 61 ITD 227, V.N. Parekh Securities Pvt. Ltd. (ITA Nos. 3316 & 3317/Mum/2004)*.

However, it may be noted here that Bombay High Court in case of *M/s. Triumph International Finance Ltd. (345 ITR 270)* held that when loan/deposit has been repaid by merely debiting account through journal entries, it must be held that assessee has contravened provisions of section 269T. In the said case, no penalty was levied for the reason that assessee had shown reasonable cause and therefore relief was granted u/s. 273B of the Act.

2. *Whether current account transactions between sister concerns or related parties amount to violation of section 269SS and 269T and thereby, penalty u/s. 271D and 271E is leviable?*

Any payments or repayments made pursuant to current account maintained between parties cannot be considered as violation of 269SS and 269T *CIT vs. Idhayam Publications Ltd., (2006) 285 ITR 221 (Mad.)* In this case there was a current account in the books of the assessee in the name of one of the directors who used to pay money into the current account and also withdraw money from the same. The department treated these payments and withdrawals as violation of section 269T as they were made in cash. Disapproving the action of the department the High Court has held that "the deposit and withdrawal of money from the current account could not be considered as a loan or advance".

In case of *Indore Plastics* (262 ITR 163) (MP HC) it is held that once it was found that payment made by promoter of assessee-company to assessee was not by way of deposit or loan, but towards adjustment of amount drawn by him from assessee's account, no penalty to be levied.

Similar view taken by ITAT Bench, B, Bangalore in the case of *M/s. Canara Housing Development Co. vs. ACIT ITA No.1425/Bang/2008*.

3. *Whether when the loan or deposit is treated as income of the assessee, can penalty be imposed on the same transactions ?*

In the case of *CIT vs. Standard Brands Ltd.* (2006) 285 ITR 295, it has been held that where deposit received in cash has been treated as undisclosed income in the hands of the assessee, no substantial question of law arises from the order of Tribunal wherein penalty u/s. 271D is deleted. Further, Delhi High Court has also held the same view in case of *R. P. Singh & Co.* (340 ITR 217). It was held by Jodhpur Tribunal in *Bajrang Textiles vs. Additional CIT [2009] 122 (JD.) 190* that where the A.O. having treated the impugned amount of deposit as income, he is precluded from treating the same amount as deposit or loan for the purpose of section 269SS and levy penalty u/s. 271D. This being the same amount cannot be treated differently at the same time both as Income & as well as "Loan / Deposit / any specified sum" as referred under the section.

4. *Meaning of loan or deposit ?*

In the case of *Baidyanath Plastic Industries (P) Ltd.* 230 ITR 522. In case of Loan it is ordinarily the duty of the debtor to seek out the creditor and to repay the money according to the agreement. However in the case of deposit it is generally the duty of the creditors to seek the depositor and make a demand for it.

While Articles 19 and 21 of the Limitation Act fix the period within which a suit for recovery of a loan can be filed which is three years from date of borrowing, Article 22 deals with the period of limitation for suits for money on account of deposit which is three years from the date demand is made by the depositor.

Reliance was placed on the decision of *Director of Income Tax (Exemption) vs. ACME Educational Society* 326 ITR 146 wherein it was held that a loan grants temporary use of money, or temporary accommodation, and that the essence of a deposit is that there must be a liability to return it to the party by whom or on whose behalf it has been made, on fulfilment of certain conditions.

Trade deposits are included in the definition of deposit for the applicability of section 269SS. Generally, trade-deposits are accepted or given to fulfil the heavy demand of certain commodity. So, it is pertinent that such deposits are in the nature of advance. In such cases, on account of failure to meet demand, the person who had received the advance is under a legal obligation to return it. When deposits are taken, certainly it has to be returned after certain period of time. This view was taken by Allahabad High Court in the case of *Chaubhey Overseas Corporation vs. CIT [2008] 303 ITR 9 (All)*.

5. *Whether receipt of share application money in cash amounts to violation of section 269SS?*

No, share application money in case is neither a loan nor a deposit as held by the Delhi High Court in the case of *CIT Delhi IV vs. I.P. India Pvt. Ltd.* 343 ITR 353 observing that "the receipt of share application monies from the three private limited companies for allotment of shares in the assessee-company cannot be treated as receipt of loan or deposit. However the transaction should be *bona fide* and shares should have been issued or otherwise if the shares have not been issued and money is

repaid the intention of receiving the money as share application money should be clear which can be established by showing that authorised capital has been increased or later on shares have been issued.

However, Jharkhand High Court in case of *Bhalotia Engineering Works Pvt. Ltd.* (275 ITR 399) held the contrary view that even if share application money cannot be considered as loan within meaning of section 269SS, it partakes of character of deposit, since it is repayable in specie on refusal to allot shares and is repayable if recalled by applicant, before allotment of shares and conclusion of contract and, therefore, acceptance of said money in cash amounting to ₹ 20,000 or more would violate provisions of section 269SS.

6. Whether receipt and payment of partners capital by partnership firm amounts to violation of Section 269SS and 269T?

The amount deposited by partner to the firm as capital contribution is not loan or deposit of money. It is so because there cannot be a contract of service between a firm and one of its partners. For the purpose of Sections 269SS and 269T, the firm and partners cannot be considered to be separate entity. Thus, amount paid by partners to firm or *vice-versa* is a payment to self and does not partake the character of loan or deposit in the normal course of business. This view was taken in *CIT vs. R. M. Chidambaram Pillai etc.* [1977] 106 ITR 292 (SC) and *ITO, Ward 2(1) vs. Universal Associates, 2011-TIOL-498-ITAT-AHM*. Even, in case of *CIT vs. Lokhpat Film Exchange (Cinema)* [2008] 304 ITR 172 (Raj.) held that Amount paid by firm to partners or *vice versa* is payment to self and does not partake the character of loan or deposit in general law. Also, it has been upheld by *Muthoot Financiers* (371 ITR 408) (Del. HC).

7. Whether cash advance for business purpose would be covered under the provisions of Section 269SS?

CIT vs. Kailash Chandra Deepak Kumar (317 ITR 351) (All. HC) held that provisions under section 269SS are applicable only in case of loan or deposit and do not cover cash advance for purpose of goods in future. Relying on the said interpretation any business transactions would not get covered u/s. 269SS and 269T.

CIT vs. Khariti Lal & Co. (270 ITR 445) (P&H HC) has also upheld the above proposition.

Bona fide Belief

Section 273B of the Act provides that if assessee proves that there was any reasonable cause for failure then penalty may not be imposed on the assessee. For further details on Section 273B of the Act, kindly refer Chapter on 'Power to reduce / waive penalty etc. grant immunity' of the said edition.

Following situations have been construed as reasonable cause and thereby penalty u/s. 272B of the Act was deleted:

In case of *CIT vs. Dimpal Yadav* (2015) 379 ITR 177 (All.), it was held that where even though assessee had taken a loan in cash, since loan was routed through bank account of assessee for payment to Government for converting land into freehold property, no penalty could be imposed under section 271D as there was a reasonable belief and genuineness of transaction was not doubted.

In the case of *CIT vs. Sunil Kumar Goel*, (2009) 315 ITR 163 (P&H) it has been mentioned that under section 273B, the assessee is permitted to show cause and tender explanation. The explanation of the assessee was found to be *bona fide* by the tribunal and it was also held that it was not aimed at avoiding any tax liability. The genuineness of the transaction was accepted.

In the case of *CIT vs. Balaji Traders* (2008) 303 ITR 312 (Mad.) it has been held that deletion of penalty was justified in a case where: (i) creditors are genuine and transactions not

doubted (ii) there is no revenue loss to the exchequer, and (iii) there is business exigency forcing the assessee to take cash loan.

In the case of *Omec Engineers vs. CIT (2007) 294 ITR 599*, it was held that where there is no finding that transactions were not genuine and there is no *mala fide* intention, the penalty could not be sustained in law.

In the case of *Maheshwari Nirman Udyog (2008) 302 ITR 201*, it has been held that where a reasonable explanation is furnished, levy of penalty u/s. 271D is not justified.

Held in *Mrs. Rupali R. Desai vs. ACIT 88 ITD 76 (Mum.)*. In *ITO vs. Shree Mahaveer Industries 82 TTJ 549 (Jd.)* it was held that cash paid to meet medical treatment expenditure in emergency, does not attract penalty u/s 271D.

In *ITO vs. Prabhulal Sahu [2006] 99 TTJ (Jd.) 177* it was held that assessee was not aware of provisions of section 269SS or 269T. His counsel did not apprise him about the provisions. No penalty u/s. 271D shall be attracted.

Where depositors residing in rural areas are not having access to banking facility and are ignorant of relevant provisions of law, it would constitute *bona fide* reasons for payment in cash. (*ACIT vs. Vinman Finance & Leasing Ltd. [2008] 306 ITR (AT) 377 (Visakhaa.)*)

Loan given by relatives on Sunday for safe custody and for use in business. No contravention of section 269SS takes place – *ITO vs. T.R. Rangarajan [2005] 279 ITR 587 (Mad.)*

Cash Transaction made on Sunday. No penalty could be imposed in such a case. *ITO vs. Narsing Ram Ashok Kumar [1993] 47 ITD 38 (Pat.)*

Transfer of money exceeding ₹ 20,000 by way of bank voucher instead of a/c payee cheque or draft does not attract penalty u/s. 271D as the transaction are through banking channels

only held in *Asst. CIT vs. Jag Vijay Auto Finance (P) Ltd.[2000] 68 TTJ (Jp.) 44*.

Loan in cash under compelling circumstances have been held to be reasonable cause: *Industrial Enterprises vs. DCIT [2000] 68 TTJ (Hyd.) 373*

Where the lenders did not have any bank account which compelled the assessee to accept the loan in cash. This has been considered as reasonable cause in *Balaji Traders vs. DCIT [2001] 73 TTJ (Pune) 246*.

CIT vs. Bombay Conductors & Electricals Ltd. (301 ITR 434) (Guj. HC) held that once there was no evidence on record to show that infraction of the provisions was with knowledge or in defiance of the provisions. It was further held that there was nothing on record to indicate that the assessee had indulged in any tax planning or tax evasion. On the contrary, the Tribunal had recorded that by making the book entries, the assessee had made the adjustment *bona fide* without having the knowledge that such book entries would render it liable to penalty under section 271D on account of violation of provisions of section 269SS. Thus, there was a reasonable cause and, hence, no penalty was leviable.

The provisions of sections 269SS and 269T have been enacted with a view to prevent the increase in black money and to stop the tax evasion. It can thus be fairly concluded that even if conditions of sections 269SS and 269T are contravened, penalty may not be levied u/s. 271D/ 271E of the Act if assessee proves that there exists *bona fide* belief and there is no intention to avoid tax.

Section – 272B : Penalty for failure to comply with provisions of section 139A

Section 272B of the Income-tax Act, 1961 ('the Act') provides for levy of penalty on any

person if such persons fail to comply with the provisions of section 139A of the Act.

Section 139A of the Act mandates certain persons to obtain PAN. Further, Section 139A of the Act also mandates certain persons to quote PAN in certain transactions as specified in the said section.

Sub-section (1) of the Section 272B provides that Assessing Officer can direct any person to pay penalty of ₹ 10,000/-, if such person has failed to comply with the provisions of Section 139A of the Act.

Sub-section (2) of the Section 272B provides that Assessing Officer can direct any person to pay penalty of ₹ 10,000/-, if such person falsely quotes its PAN as required in section 139A(5)(c) of the Act or falsely intimates its PAN as required in section 139A(5A) or 139A(5C) of the Act. Hence, if any person falsely quotes/intimates its PAN then penalty can be levied by Assessing Officer under the aforesaid sub-section. Assessee cannot thereby take recourse to sub-section (1) by contesting that compliance has been made u/s. 139A of the Act by quoting/intimating PAN; as penalty can be levied under sub-section (2) if it is falsely quoted/intimated.

Further, no penalty shall be levied without providing any opportunity of being heard to the assessee.

Section 273B of the Act provides that if assessee proves that there was any reasonable cause for failure then penalty may not be imposed on the assessee. For further details on Section 273B of the Act, kindly refer Chapter on 'Power to reduce / waive penalty etc. grant immunity' of the said edition.

Following situations have been construed as reasonable cause and thereby penalty u/s. 272B of the Act was deleted:

a. Penalty not imposable under section 272B where assessee failed to mention

correct PAN of few deductees in quarterly e-TDS return which in fact were not available with it at relevant time but on being show-caused it obtained correct PANs and filed revised return (2015) 43 ITR(T) 162 (Del. ITAT).

- b. Since default made on part of assessee was because of her ignorance and not because of any *mala fide* intention, penalty levied under section 272B was deleted (2015) 39 ITR(T) 556 (Ahmd. ITAT)
- c. Assessee-deductor did not mention PAN of deductees on TDS certificates issued by it, as deductees did not provide same, penalty for non-compliance could not be imposed (2013) 356 ITR 711 (All. HC)
- d. Where assessee quoted wrong PAN of deductees at time of filing e-TDS statements and said mistake was rectified as soon as it came to assessee's notice, no penalty can be levied (2012) 349 ITR 550 (P&H HC).
- e. Merely because proof of address and permanent account number of many account holders could not be produced at time of survey due to shifting of branch, penalty under section 272B could not be levied since it would be almost impossible for bank to collect such huge number of documentary record within a fortnight (2012) 252 CTR 222 (Guj. HC).

One important question may arise at this juncture that whether penalty of ₹ 10,000/- is to be levied per person or the number of defaults regarding the PAN quoted. i.e. if one assessee has quoted 10 wrong PAN then whether penalty should be ₹ 10,000 or ₹ 1,00,000/-. From the literal reading of the aforesaid section, it can fairly be concluded that penalty is to be levied deductor-wise i.e., penalty leviable would be ₹ 10,000/- irrespective of number of wrong quotation of PANs. Said view is supported by CBDT in the letter dated 5-8-2008 *vide* No. 275/24/2007-

IT(B) wherein it has been clarified that penalty of ₹ 10,000/- under Section 272B is linked to the person, i.e., the deductor who is responsible to deduct TDS, and not to the number of defaults regarding the PAN quoted in the TDS return. Delhi High Court in case of *CIT vs. DHTC Logistics Ltd. (221 Taxman 83)* has also held that regardless of the number of defaults in each return, maximum penalty of ₹ 10,000/- can be imposed on the deductor. Penalty cannot be imposed by calculating the number of defective entries in each return and by multiplying them with ₹ 10,000/-.

Section 271F – Penalty for failure to furnish Return of Income and Section 234F – Fees for delay in filing of return

As per Section 271F of the Act, Assessing Officer may direct any person who is required to furnish return u/s. 139(1) to pay penalty of ₹ 5,000/- if such person fails to furnish its return before the end of relevant assessment year.

Section 273B of the Act provides that if assessee proves that there was any reasonable cause for non-filing of return then penalty may not be imposed on the assessee. For further details on Section 273B of the Act, kindly refer Chapter on 'Power to reduce / waive penalty etc grant immunity' of the said edition.

Finance Bill, 2017 decided to do away with the ambiguity of a penalty on late filing of return of income, and has instead introduced a fee for late filing of return of income. Section 234F has been introduced w.e.f. AY 2018-19 onwards, to levy a late filing fee on a person who does not file his return of income within time prescribed under section 139(1) of the Act. Consequently, penalty under section 271F will not be levied from AY 2018-19 onwards.

Reason for introduction of such fee was explained by Memorandum to the Finance Bill, 2017 which stated that there was a desire to

improve tax compliance by encouraging non-intrusive information driven approach so as to ensure effective utilisation of such information by the tax administration. Further, filing of return of income on time is a necessary precursor to introduce corresponding reduction in the time limits for assessments.

The fee structure is as follows:

Particulars	Fee
If return is furnished on or before 31st December of the Assessment Year	₹ 5,000
If return is furnished after 31st December of the Assessment Year	₹ 10,000

However, If the total income of a person does not exceed ₹ 5,00,000, then the fee shall not exceed ₹ 1,000/-.

Further, since the trigger for the levy of fee is requirement of filing return of income u/s. 139(1), no fee is leviable in case a person's (other than a company or a firm) income is below the taxable limit.

It is to be noted that levy of such fee is mandatory and it is unlike Section 271F of the Act wherein penalty can be waived off u/s. 273B of the Act, if assessee shows any reasonable cause for delay in filing return. Immunity available u/s. 271F r.w.s 273B of the Act is not available to assessee's for return filed u/s. 139 (1) for AY 2018-19 & onwards.

However, levy of a flat fee may be burdensome on taxpayers, who did not file their return of income within the prescribed time limit, due to genuine hardship and difficulty. Further, question also arises on whether the fee is payable in cases where there is no tax payable. There is no loss of revenue to the Government in case there is excess advance tax paid or excess TDS has been deducted. Levy of a late-filing fee in such scenarios may be debated.

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Dharan Gandhi, Advocate

Power to reduce/waive penalty etc. grant immunity

“The Explanations appended to section 271(1)(c) of the Income-tax Act entirely indicates the element of strict liability on the assessee for concealment or for giving inaccurate particulars while filing return..... Object behind enactment of section 271(1)(c) read with Explanations indicate that the said section has been enacted to provide for a remedy for loss of revenue. The penalty under that provision is a civil liability. Wilful concealment is not an essential ingredient for attracting civil liability as is the case in the matter of prosecution under section 276C of the Income-tax Act” the above extract is from the judgment of the Hon’ble Apex Court in case of *UOI vs. Dharamendra Textile Processors reported in 306 ITR 277*. The above extract is reproduced to highlight the fact that penalty under Income-tax law is considered as a civil liability and that there is no requirement of proving *mens rea* while levying penalty. Once the condition for levy of penalty is satisfied i.e. the offence is proved, penalty is inevitable. However, the Act has provided for certain safeguards. In the present article, I shall be dealing with those safeguards.

The penalty provisions under the Act are contained in Chapter XXI of the Act – ‘Penalties Imposable’. It starts with section 270A and ends with section 275. From section 270A to section 273, different offences are prescribed along with

applicable monetary penalties. Section 274 deals with procedures for imposing penalties whereas section 275 deals with bar of limitation for imposing penalties. Chapter XXI also contains sections 273A, 273AA and 273B which provides for waiver/reduction of and protection from imposition of penalties which is the subject matter of the present article.

Section 273A – Power to reduce or waive penalty, etc., in certain cases

Section 273A was first inserted by the Taxation Laws (Amendment) Act, 1975, w.e.f. 1-10-1975. Mainly there are two provisions u/s. 273A which provides power to the CIT to reduce or waive penalty i.e. sub-sections (1) and (4). Both are independent of each other. Firstly, we shall analyse power u/s. 273A(1) and the related provisions.

Sections 273A(1), 273A(2) and 273A(3)

Section 273A(1) begins with a non-obstante clause. It states that notwithstanding anything contained in the Act, Pr. CIT or CIT (hereinafter referred to as CIT) may, in his discretion, whether on his own motion or otherwise, reduce or waive the amount of penalty imposed or imposable on a person u/s. 270A or u/s. 271(1)(iii) if he is satisfied that

- a. such person has, prior to the detection by the Assessing Officer of the concealment of particulars of income or of the inaccuracy of particulars furnished in respect of such income, voluntarily and in good faith, made full and true disclosure of such particulars, and
- b. also has co-operated in any enquiry relating to the assessment of his income and
- c. has either paid or made satisfactory arrangements for the payment of any tax or interest payable in consequence of an order passed under this Act in respect of the relevant assessment year.

Also, it has been clarified in the Explanation to section 273A(1) that a person shall be deemed to have made full and true disclosure of his income or of the particulars relating thereto in any case where the excess of income assessed over the income returned is of such a nature as not to attract the provisions of section 270A or section 271(1)(c).

The section thus, applies notwithstanding anything contained in any provisions of the Act. The power to review is available with CIT or Pr. CIT and the power can be exercised either on application by the assessee or *suo-motu*. Practically speaking, in the current scenario where the Commissioners are hell bent behind recovery of taxes so as to complete their respective quotas, the term '*suo-motu*' has no relevance.

One of the most prominent features of this section is discretionary nature of the power. Merely because all the conditions as prescribed u/s. 273A(1) are fulfilled does not mean that the CIT has to grant waiver or reduction of penalty. Also, the CIT may decide to reduce the amount of penalty instead of granting complete waiver. The said powers being discretionary cannot be put to question. However, the power/discretion needs to be exercised judiciously,

fairly, reasonably, objectively and not arbitrarily. In situations where a fairly reasonable case was made out for either reduction or waiver and the CIT refused to grant the same, the Courts have interfered in the discretion of the Commissioners. The Hon'ble Bombay High Court in case of *Madhuri vs. CIT (325 ITR 0268)* and in case of *Vasantbhai Jethalal Lathiwala vs. CIT (325 ITR 41)* has held that once the case is made out for waiver/reduction, the CIT needs to exercise the powers in favour of the assessee. Further, the Hon'ble Allahabad High Court in case of *Kailash Mills vs. CIT (260 ITR 322)* held that if conditions in section 273A(1)(c) are fulfilled, CIT must give some relief, though he has discretion in granting either total waiver or partial waiver depending on facts of each case, but he cannot reject application under section 273A in toto.

The power under this section can be exercised either before or after levy of penalty, as the section uses the term 'imposed' or 'imposable'.

Relief u/s. 273A(1) can be claimed in respect of penalty imposable u/s. 270A i.e. a case of under-reporting or misreporting of income and penalty imposable u/s. 271(1)(iii) dealing with furnishing inaccurate particulars of income or concealment of particulars of income. Section 270A of the Act is successor of section 271(1)(c) and it applies w.e.f. AY 2017-18. In so far as section 270A is concerned, the waiver or reduction u/s. 273A is an alternate relief and distinct from immunity which can be granted u/s. 270AA from levy of penalty and prosecution in case of under-reporting of income subject to fulfilment of conditions prescribed therein.

All the following conditions should be satisfied cumulatively for section 273A(1) to apply:

- a. there has to be a voluntary, true and full disclosure in good faith prior to detection by the Assessing Officer
- b. assessee has to co-operate in the enquiry relating to the assessment

- c. has to either make payment of tax or interest or make satisfactory arrangement for payment of such tax and interest in respect of the relevant assessment year.

Firstly, it can be seen that the above conditions are exhaustive in nature. If all the above conditions are fulfilled, then the CIT cannot reject the application of waiver on any other grounds. The High Courts have held that the CIT should confine themselves to the factors enumerated in the section 273A and should not resort to any alien condition to deny relief to the applicant. The Hon'ble Bombay High Court in case of *Shrikrishna S. Bhagwat vs. CIT* (270 ITR 186) has held that non-payment of advance tax was not a relevant condition while considering application u/s. 273A. If one compares the wordings of section 271AAB with section 273A, it can be discerned that one of the requirements for getting reduced rate of penalty u/s. 271AAB is that the assessee has to substantiate the manner in which the undisclosed income was derived. This condition is not present in section 273A and therefore, cannot be a reason to reject an application under the said section.

First condition to be fulfilled as brought out in point 'a' above has several elements viz. disclosure has to be voluntary, it has to be full and true, it has to be in good faith and it has to be prior to detection by the Assessing Officer. If any of the conditions are not fulfilled then there cannot be any relief u/s. 273A(1). The second condition states that the assessee has to co-operate during the assessment proceedings. Thus, one has to make a voluntary, full and true disclosure before the detection by the Assessing Officer and has to co-operate during the assessment proceedings.

An issue of general notice u/s. 142(1) or 143(2) cannot be termed as detection by the Assessing Officer. Therefore, after issue of said notices, if the assessee discloses the income which comes to his knowledge while complying with the notices issued by the officer, it would still amount to a voluntary disclosure without detection by the

Assessing Officer. Relevant judgment in this regard would be that of the Hon'ble Delhi High Court in case of *CIT vs. Harnarain* (67 DTR 172), wherein when assessee agreed for addition, on being asked with a simple question, the Court held that there was a voluntary disclosure prior to the detection by the officer. Similar is the finding by the Hon'ble Rajasthan High Court in case of *J.P. Sharma & Sons vs. CIT* (151 ITR 333) and by the Hon'ble Bombay High Court in case of *Dr. (Mrs.) Sudha Kankariya vs. CIT* (270 ITR 296). However, once an officer has some definitive information in his possession and without any option to wriggle out, the assessee surrenders, then the disclosure made by the assessee would not be termed as voluntary without prior detection by the Assessing Officer. Also, there is no requirement that the Assessing Officer has to issue a show-cause notice prior to voluntary surrender to prove that there was prior detection by the officer.

In case, where a search or survey action has taken place and the assessee thereafter surrenders the income, whether in such cases, the waiver application can be accepted is a contentious issue. Majority of the courts have held that a disclosure made after being forced to in light of material found during search/survey action is not voluntary one and therefore, would not entitle one for waiver u/s. 273A [See *CIT vs. Bansal Abushan Bhandar* – 264 CTR 102(P&H); *Shardadevi P. Jhunjhunwala vs. CIT* – 327 ITR 211 (Bom.); *Ram Lal Roshan Lal (HUF) vs. CIT* – 299 ITR 431 (All.); *C. Christopher vs. CIT* - 268 ITR 511 (Mad.)]. Further, some have gone to the extent that co-operation during search proceedings also would not better the case u/s. 273A. Also, it has been held that even if the incriminating material found during the course of search would not have led to quantification of exact amount of undisclosed income, the assessee's disclosure in such circumstances would not be termed as voluntary one thus disabling him from claiming waiver u/s. 273A.

It should be noted in this regard that the disclosure has to be voluntary and prior to the

detection by the Assessing Officer. Assessing Officer has been defined u/s. 2(7A) and the definition does not include the investigation officer in charge of search and survey unless both the persons are same. Therefore, if a person makes a voluntary surrender during the search proceedings and offer the income to tax in return of income filed in pursuance of such search, then the same is prior to detection by the Assessing Officer, as the assessment would surface into picture after the completion of the investigation. Therefore, technically speaking the conditions of voluntary disclosure prior to detection by the Assessing Officer is fulfilled even in a case where the disclosure is subsequent to any search or survey action. The section doesn't require disclosure before being caught by any limb of the income tax department.

Also, one should appreciate the purpose behind the section. If the case of the assessee is good on merits, i.e. where the case does not require imposition of penalty, there is no point going to CIT for waiver or reduction. It is only when a person is liable for penalty, he will approach the CIT u/s. 273A. Therefore, in a case of search where the person has co-operated during the search proceedings and has made full and true disclosure, his case should be considered for waiver u/s. 273A.

Next, let us deal with the term 'good faith'. The section requires that the disclosure is made in good faith. The term 'good faith' should receive wide interpretation. Though there may be an element of *mens rea* while filing return of income, however, if prior to the detection by the Assessing Officer, the assessee makes a voluntary disclosure, then his case of waiver should not be rejected by taking into consideration the intention at the time of filing of return. Rather, the term 'good faith' symbolises the intention of the person at the time of making disclosure irrespective of his past behaviour. Thus, where a person makes a *bona fide* disclosure and satisfies other conditions of section 273A, waiver or reduction should not be rejected on the ground that there was *mens*

rea at the time of filing of the return of income. Subsequent conduct of coming clean should be given importance. However, if the person comes clean but in an incomplete manner, the CIT may use his discretion against the person.

Third condition requires either making of payment of tax or interest or making of satisfactory arrangement for payment of the same in respect of the relevant assessment year. Once the assessee is able to prove that he has made satisfactory arrangement for payment of tax or interest, then he shall not be required by the CIT to make payment of tax or interest. Also, payment of penalty or satisfactory arrangement for payment of penalty is not a condition precedent for availing the benefit of section 273A, as the section only deals with tax and interest. The Hon'ble Delhi High Court in case of *Asha Pal Gulati vs. CBDT (361 ITR 73)*, has held that there is no need for one to pay penalty or interest u/s. 220 for the purpose of section 273A. Also, it is to be noted that the condition requires one to either make arrangement or make payment of tax and interest in respect of the relevant assessment years in respect of which an application is made and therefore, merely because tax dues of some other years are pending, cannot be a reason to deny a claim u/s. 273A.

Section 273A(2) provides that where the amount of income in respect of which the penalty is imposed or imposable for the relevant assessment year, or, where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years, exceeds a sum of five hundred thousand rupees, then the order for reduction or waiver of penalty would be passed by the CIT only after the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General.

Section 273A(3) states that where an order has been made under sub-section (1) in favour of any person, whether such order relates to one or more assessment years, he shall not be entitled

to any relief under this section in relation to any other assessment year at any time after the making of such order.

Thus, section 273A(2) states that where the amount of income in respect of which the penalty is imposed or imposable exceeds ₹ 5 lakh, then the CIT would be required to get previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General as the case may be for the purpose of section 273A. The issue here would be whether, the Chief Commissioner or Director General would be required to give an opportunity of being heard to the applicant prior to giving approval. The Hon'ble Allahabad High Court in case of *Hari Om Jindal vs. CCIT (8 taxmann.com 188)* has held that where the CCIT proposes to refuse approval, principle of natural justice has to be observed and opportunity of hearing should be given to assessee. In this regard also it would be worthwhile to refer to the recent judgment of the Hon'ble Bombay High Court in case of *Maharaj Garage and Co. vs. CIT (400 ITR 292)*, wherein the Court was dealing with the issue of opportunity of hearing to be granted by the Inspecting Assistant Commissioner while approving the order of the Assessing Officer levying penalty u/s. 271(1)(c). The Court held that power of granting approval is purely administrative in nature and therefore, would not require giving another opportunity of being heard especially when the section does not contemplate so. Even section 273A(2) does not specify opportunity of being heard to be given to the applicant, therefore, one may argue in Bombay jurisdiction, that section 273A(2) does not require giving opportunity of being heard by CC or DG before refusing approval.

Section 273A(2) also provides an important insight. It states that where the income in respect of which the penalty is imposed or imposable or, where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years, exceeds

a sum of five hundred thousand rupees, then previous approval would be required. Thus, an application can also be made for waiver or reduction of penalty u/s. 273A for several assessment years together. Application can be made in a case where in respect of one year penalty has already been imposed as well as for the year in respect of which penalty is yet to be imposed. This also assumes significance because of provision of section 273A(3). Section 273A(3) states that where a relief has been granted u/s 273A(1), whether such order relates to one or more assessment years, he shall not be entitled to any relief under this section. Thus, one may think of making an application for several years together. Also, various Courts have held that an application can be made for various years together and need not be restricted to one year [*Sukhdev Hargopal Puri vs. UOI - 279 ITR 591 (Bom)*, *Sivaram Textiles vs. CIT- 244 ITR 136 (Mad)* and *Sanjana Films vs. CIT - 250 ITR 304 (AP)*].

As already stated above, relief if once allowed u/s. 273A(1), then no further relief would be available u/s. 273A. The above section would apply only if relief has been allowed u/s. 273A(1). In a case where an application for waiver/reduction is not allowed, then there is no question of claiming relief twice. Also, the section uses the term order is in favour u/s. 273A(1), which means that even if instead of waiver of penalty, reduction is allowed, that would amount to a favourable order u/s. 273A(1) and which would then lead to permanent closure of gate for any further relief u/s. 273A. In a case before the Hon'ble Punjab and Haryana High Court where an application was filed for waiver of penalty, but no order was passed, the Court held that assessee was entitled to claim benefit of waiver under section 273A for all assessment years by having his application considered by Commissioner by a common order (See *Mohinder Singh vs. CIT - 353 ITR 278*).

273A(4), 273A(4A)

Now we analyse the second power of waiver/reduction given to the Commissioners

u/s. 273A(4). Section 273A(4) provides another power to the Pr. CIT or CIT and which is distinct from the powers given u/s. 273A(1). It states that without prejudice to the powers conferred on him by any other provision of this Act, the Pr. CIT or CIT may, on an application made in this behalf by an assessee, and after recording his reasons for so doing, reduce or waive the amount of any penalty payable by the assessee under this Act or stay or compound any proceeding for the recovery of any such amount if he is satisfied that—

- a. to do otherwise would cause genuine hardship to the assessee, having regard to the circumstances of the case; and
- b. the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Thus, the power u/s. 273A(4) is independent of other section. The conditions prescribed under this section are different as compared to section 273A(1). Under this section, two conditions need to be satisfied for the CIT to exercise power viz. if the CIT does not exercise his power then the assessee would be under genuine hardship and that the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him. Thus, the conditions prescribed here are exhaustive. The CIT cannot take into considerations the conditions prescribed u/s. 273A(1) viz. voluntary disclosure while dealing with an application u/s 273A(4), as for section 273A(4) he has to take into consideration the factor of genuine hardship [See *Ram Lal Roshan Lal (HUF) vs. CIT – 299 ITR 431 (All)*].

The powers given to CIT under this sub-section are different, wherein apart from the power to waive or reduce penalty, CIT also has power to stay or compound any proceeding for the recovery of penalty. Further this section applies in respect of any penalty levied under the Act, unlike section 273A(1) which applies only in case

of section 270A or 271(1)(iii). Further, a person can also apply u/s. 273A(4) in respect of offences u/ss. 270A and 271(1)(iii). The powers under this section can be used only when an application has been made, while u/s. 273A(1) the powers can also be applied *suo-motu*.

The proviso to section 273A(4) states that where the amount of any penalty payable under this Act or, where such application relates to more than one penalty, the aggregate amount of such penalties exceeds ₹ 1 lakh, no order reducing or waiving the amount or compounding any proceeding for its recovery under this sub-section shall be made by Pr. CIT or CIT except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be. Approval under proviso to section 273A(4) is required when the amount of penalty exceeds one lakh rupees whereas approval u/s. 273A(2) is required where the income in respect of which penalty is imposed or impossible exceeds five lakh rupees.

Also, one may note that if relief has been granted u/s. 273A(4) then, section 273A(3) would not apply. One can claim any number of reliefs u/s. 273A(4). However, once a relief is obtained u/s. 273A(1), he shall not be eligible for relief under any provisions of section 273A. In my view, entitlement of only one relief in entire lifetime should be restricted to section 273A(1) and should not extended to section 273A(4), as the conditions set out in 273A(4) are in respect of genuine hardships faced by the assessee, which the assessee may face more than one in his lifetime. Further, if relief is allowed once u/s. 273A(1), doors cannot be closed for a genuine assessee u/s. 273A(4).

Section 273A(4A) provides that the order under sub-section (4), either accepting or rejecting the application in full or in part, shall be passed within a period of 12 months from the end of the month in which the application under the said sub-section is received by the Principal Commissioner or the Commissioner. It is also

provided that no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

Section 273A(5)

The orders passed u/s. 273A are not appealable and are final as section 273A(5) states that every order made under this section shall not be called into question by any court or any other authority. However, one can always resort to constitutional remedies like a petition under Article 226. Section 273A provides discretionary powers to the Commissioners, therefore, the Court cannot themselves sit on the chair of CIT and use such discretionary powers. However, the Court can verify whether the Commissioner has exercised the powers in a judicious and reasonable manner and if it is found by the Court that the Commissioner has been arbitrary and capricious in his approach, then the Court can vacate his findings and can ask him to re-approach the application.

One may also note that there is no prior requirement that no appeal should have been filed against the penalty order before approaching the Commissioner. Thus, one can simultaneously file an appeal and also approach the Commissioner for waiver/reduction of penalty.

Lastly, section 279(1A) states that a person shall not be proceeded against for an offence under section 276C or section 277 in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable on him u/s 270A or 271(1)(iii) has been reduced or waived by an order under section 273A.

273AA – Power of Commissioner to grant immunity from penalty

Section 273AA applies in a case where there is abatement of Settlement Commission application u/s. 245HA. It states that a person may make an application to the Pr. CIT or CIT for granting immunity from penalty, if —

- a. he has made an application for settlement under section 245C and the proceedings for settlement have abated under section 245HA; and
- b. the penalty proceedings have been initiated under this Act.

The above application is to be made before imposition of penalty after abatement of the proceedings. Thus, unlike section 273A where an application can be made either before or after imposition of penalty, u/s. 273AA, an application for immunity has to be made only before the imposition of penalty. The Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from the imposition of any penalty under this Act, if he is satisfied that the person has, after the abatement,

- a. co-operated with the income-tax authority in the proceedings before him and
- b. has made a full and true disclosure of his income and
- c. the manner in which such income has been derived.

Thus, the above conditions needs to be fulfilled cumulatively for an application to be accepted. One of the conditions prescribed for granting immunity is to reveal the manner in which such income is derived. This condition was not present u/s. 273A. One can also think of invoking remedy prescribed u/s. 273A instead of section 273AA. However, in case where the settlement application has been filed post the search proceedings, and the disclosure is made in light of the incriminating material found during the course of search, the Courts have taken a view that such disclosure is not a voluntary disclosure before detection by the Assessing Officer. Nevertheless, one can make an application u/s. 273A(4), if the case of genuine hardship to the assessee is made out.

The Commissioner has to pass an order, either accepting or rejecting the application in full or

in part, within a period of twelve months from the end of the month in which the application is received by him. Provided that no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

The Commissioner also has powers to withdraw the immunity granted to a person under this section, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted. The immunity granted to a person may also be withdrawn any time by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person shall become liable to the imposition of any penalty under this Act to which such person would have been liable, had no such immunity been granted.

Similar powers are also granted to the Pr. Commissioner or the Commissioner u/s. 278AB to grant immunity from prosecution.

273B – Penalty not to be imposed in certain cases

Section 273B is the best safeguard available under the income tax law from penalty. It states that notwithstanding anything contained in the penalty provisions as prescribed in the said section, no penalty shall be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provisions if he proves that there was reasonable cause for the said failure.

The term 'reasonable cause' has not been defined in the Act. However, it has been a subject matter of interpretation by various courts. The Hon'ble Delhi High Court in case of *Woodward Governors India (P.) Ltd. vs. CIT* (253 ITR 745) has held that "Reasonable cause as applied to human

action is that which would constrain a person of average intelligence and ordinary prudence. It can be described as a probable cause. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which assuming them to be true, would reasonably lead any ordinarily prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that same was the right thing to do. The cause shown has to be considered and only if it is found to be frivolous, without substance or foundation, the prescribed consequences follow."

Similarly, the Hon'ble Bombay High Court in case of *CIT vs. Triumph International Finance (I) Ltd.* (345 ITR 270) has held that 'The expression 'reasonable cause' used in section 273B is not defined under the Act. Unlike the expression 'sufficient cause' used in sections 249(3), 253(5) and 260A(2A) of the Act, the legislature has used the expression 'reasonable cause' in Section 273B of the Act. A cause which is reasonable may not be a sufficient cause. Thus, the expression 'reasonable cause' would have wider connotation than the expression 'sufficient cause'. Therefore, the expression 'reasonable cause' in section 273B for non-imposition of penalty under section 271E would have to be construed liberally depending upon the facts of each case.'

The Hon'ble Patna High Court in case of *Sonali Autos (P.) Ltd. vs. State of Bihar* (396 ITR 636) has held that 'Reasonable cause would mean a cause which prevents a reasonable man of ordinary prudence acting under normal circumstances, without negligence or inaction or want of bonafides.'

Thus, the Courts have given a very elastic meaning to the term 'reasonable cause'. They have explained the term 'reasonable cause' to be a 'probable cause' and something which wider that the term 'sufficient cause'. Also, there are judgments of the Court dealing with the term 'reasonable cause' in context of various penalty section and which are dealt with by other authors.

The section prescribes certain penal sections but importantly not all penal sections are covered. Following sections are not getting covered u/s. 273B

- a. 270A – Penalty for underreporting and misreporting of income
- b. 271(1)(c) – Penalty for concealment or particulars of income or for furnishing inaccurate particulars of income
- c. 271AAA, 271AAB – Penalty where search has been initiated
- d. 271AAC – Penalty in respect of certain income (where income has been assessed u/s 68, 69, 69A, 69B, 69C or 69D and tax has been paid u/s. 115BBE)
- e. 271DA – Penalty for failure to comply with provisions of section 269ST
- f. 271FAA - penalty for furnishing inaccurate statement of financial transaction or reportable account u/s. 285BA.
- g. 272A(1)(a), 272A(1)(b) – Failure to answer question or refusal to sign statements
- h. 273(1)(a), 273(2)(a) and 273(2)(aa) – Section 273 deals with false estimate of, or failure to pay advance tax

Thus, in case of the offences mentioned in the above sections, even if there existed any reasonable cause, if the offence is proved, the person would be liable for penalty. As we have already seen that penalty under Income-tax law is termed as a civil liability by the Apex Court and therefore, there would be no need for the Department to prove *mens rea*. However, then the assessee would have to prove that there was no offence or that his case does not fit within the wordings of the provisions. Like, section 271FAA, 272A(1)(a), 272A(1)(b), 273(1)(a), 273(2)(a) and 273(2)(aa) contains some element of deliberate attempt on the part of the accused and therefore, it would be for one to prove that the offence was not deliberate. Similarly, in case of penalty u/s. 271(1)(c), the assessee can take a plea that there was adequate disclosure of particulars of income and that mere making of the claim would not lead to levy of penalty on the assessee as held by Hon'ble Apex Court in

case of *CIT vs. Reliance Petroproducts (P) Ltd.* (322 ITR 158).

Some of the above sections have inherent safeguards prescribed in the section itself. Like section 270A(6) prescribes certain cases, in respect of which, it shall not be deemed to be a case of underreporting of income. Explanation 1 to section 271(1)(c) required certain conditions to be fulfilled to be not deemed to be concealment of particulars of income. Section 271AAA(2) prescribes the way out of being penalised. Proviso to section 271DA itself contains a safeguard to the same effect i.e. if good and sufficient reasons are proved for contravention then no penalty shall be levied.

Also, the Court have in some cases taken liberal views. For example, if an assessee made a claim which was disallowed by the Assessing Officer and sustained by the Appellate authorities, the Courts have held that penalty is not leviable if the issue is debatable and there exist two views. Similarly, Courts have also held that imposition of penalty would be unwarranted in a case where the assessee had committed an inadvertent and *bona fide* error and had not intended to or attempted to either conceal its income or furnish inaccurate particulars (*See Price Waterhouse Coopers Pvt. Ltd. vs. CIT - 348 ITR 306*).

Conclusion

Though section 273B appears to be a natural safeguard and is always resorted to, however, usage of section 273A is not much in vogue; may be because of lack of trust on the revenue collection officers or because of our assumption of the reluctance of such officers in granting relief. Nevertheless, it would not be a bad choice to give it a try, since even if the application is rejected, the appeal remedy is still available and if any relief is granted, it automatically leads to closure of gate of prosecution; considering the fact that nowadays the issuance of prosecution notice is rampant!

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Neelam C. Jadhav, *Advocate*

Penalty Provisions under Income-tax Act

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
1.	270A (1)	Under-reporting and misreporting of income	Assessing Officer or Commissioner (Appeals) or Principal Commissioner or Commissioner	A sum equal to 50% of the amount of tax payable on under-reported income
2.	271(1)(b)	Failure to comply with notices u/s. 115WD (2) or 115WE(2) or 142(1) or 143(2) or failed to comply direction u/s. 142(2A)	Assessing Officer or the Commissioner (A p p e a l s) o r the Principal Commissioner or Commissioner	₹ 10,000/- for each failure
3.	271(1)(c)	Concealed the particulars of income or furnished inaccurate particulars of income	Assessing Officer or the Commissioner (A p p e a l s) o r the Principal Commissioner or Commissioner	100% of the tax evaded or 300% of tax evaded
4.	271(1)(d)	Concealed the particulars of fringe benefits or furnished inaccurate particulars of such fringe benefits	Assessing Officer or the Commissioner (A p p e a l s) o r the Principal Commissioner or Commissioner	100% of the tax evaded or 300% of tax evaded
5.	271A	Failed to keep, maintain or retain books of accounts and other documents u/s. 44AA	Assessing Officer or the Commissioner (Appeals)	A sum of ₹ 25,000/-

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
6.	271AA	Failed to keep, maintain information and documents in respect of an international or specified domestic transaction as required by sub-section (1) or sub-section (2) of section 92D	Assessing Officer or the Commissioner (Appeals)	A sum equal to 2% of value of each international transaction or specified domestic transaction entered. Further failed to furnish the information and documents, penalty sum of ₹ 25,000/-
7.	271AAA	Undisclosed Income where search is initiated, on or after 1/7/2007 but before 1/7/2012	Assessing Officer	10% of the undisclosed income of the specified previous year, if the assessee failed to prove the manner in which such undisclosed income is earned
8.	271AAB(1)	Undisclosed income where search is initiated, on or after 1/7/2012 but before 15/12/2016.	Assessing Officer	(i) if the assessee admits the existence of undisclosed income and the manner in which it is earned, pays taxes and furnishes its return declaring such income then penalty leviable is 10% of the undisclosed income of the specified previous year (ii) if undisclosed income is not admitted, however, assessee pays tax on such undisclosed income and files its return declaring such income, then, penalty leviable is 20% of the undisclosed income (iii) in case such undisclosed income not covered in (i) or (ii) above, penalty leviable is 30% of the undisclosed income of the specified previous year

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
9.	271AAB (1A)	Undisclosed Income where search is initiated, on or after 15/12/2016.	Assessing Officer	(i) if the assessee admits the undisclosed income and the manner in which it is earned, pays taxes and furnishes its return declaring such income, then, penalty leviable is 30% of the undisclosed income of the specified previous year (ii) in case such undisclosed income is not covered in (i) above penalty leviable is 60% of the undisclosed income of the specified previous year
10.	271AAC	Where income determined includes any income referred to in s. 68, s. 69, s. 69A, s. 69B, s. 69C or s. 69D for any previous year	Assessing Officer	The penalty in addition to tax payable under s.115BBE, a sum computed at the rate of 10% of the tax payable under clause (i) of sub-section (1) of section 115BBE
11.	271B	Failed to get accounts audited -	Assessing Officer	A sum equal to $\frac{1}{2}\%$ (half per cent) of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession or a sum of one hundred fifty thousand rupees, whichever is less.
12.	271BA	Failed to furnish report under section 92E	Assessing Officer	A sum of Rupees One Hundred Thousand
13.	271BB	Failed to subscribe to the eligible issue of capital within the period of six months specified	Joint Commissioner	A penalty, a sum equal to 20% of such amount
14.	271C	Failed to deduct tax at source	Joint Commissioner	A sum equal to the amount of tax which such person failed to deduct or pay as aforesaid

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
15.	271CA	Failed to collect tax at source	Joint Commissioner	A sum equal to the amount of tax which such person failed to collect as aforesaid
16.	271D	Failed to comply with the provisions of s.269SS	Joint Commissioner	A sum equal to the amount of the loan or deposit or specified sum so taken or accepted
17.	271DA	Failed to comply with provision of s.269ST :	Joint Commissioner	A sum equal to the amount of such receipt
18.	271E	Failed to comply with the provisions of section 269T	Joint Commissioner	A sum equal to the amount of the loan or depositor specified advance so repaid
19.	271F	Failed to furnish return of income	Assessing Officer	A sum of Rupees Five Thousand only
20.	271FA	Failed to furnish statement of financial transaction or reportable account	Income-tax authority or such other authority or agency as may be prescribed	A sum of Rupees One hundred for every day during which such failure continues. Provided further failed to furnish the statement within the period specified in the notice issued under sub-section (5) of s.285BA, penalty, a sum of five hundred rupees for every day during which the failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the statement expires.
21.	271FAA	Furnished inaccurate statement of financial transaction or reportable account	Prescribed Income-tax authority	A sum of Rupees Fifty Thousand
22.	271FAB	Failed to furnish statement or information or document by an eligible investment fund	The income-tax authority prescribed under the said sub-section	A sum of Rupees Five Hundred Thousand

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
23.	271FB	Failed to furnish return of fringe benefits	Assessing Officer	A sum of Rupees one hundred for every day
24.	271G	Failed to furnish information or document under section 92D	Assessing Officer or the Transfer Pricing Officer as referred to in s. 92CA or the Commissioner (Appeals)	A sum equal to 2 % of the value of the international transaction or specified domestic transaction for each such failure
25.	271GA	If any Indian concern fails to furnish information or document under s.285A.	The income-tax authority, as may be prescribed under the said section	i) A sum equal to 2% of the value of the transaction in respect of which such failure has taken place (ii) A sum of rupees five hundred thousand in any other case.
26.	271GB	Failed to furnish report or for furnishing inaccurate report under section 286	The income-tax authority, as may be prescribed under the said section	A sum of Rupees Five Lakh
27.	271H	Failed to deliver or cause to be delivered a statement within the time prescribed in sub-section (3) of s. 200 or the proviso to sub-section (3) of section 206C; or Furnishes incorrect information in the statement which is required to be delivered or caused to be delivered	Assessing officer	Not be less than rupees ten thousand but which may extend to rupees one lakh.
28.	271-I	Failed to furnish information or furnishing inaccurate information u/s. 195	Assessing Officer	A sum of ₹ 1,00,000/-
29.	271J	Furnished incorrect information in reports or certificates.	The Assessing Officer or the Commissioner (Appeals)	A sum of rupees ten thousand for each such report or certificate
30.	272A	Failed to answer questions, sign statements, furnish information, returns or statements, allow inspections, etc.		Sum of rupees ten thousand for each such default or failure

Sr. No.	Section and Clause	Nature of Default	Authority Levying Penalty	Minimum / Maximum Penalty
31.	272AA	Failed to comply with the provisions of section 133B	Joint Commissioner, Assistant Director or Deputy Director or the Assessing Officer	A sum which may extend to rupees one thousand
32.	272B	Failed to comply with the provisions of section 139A	Assessing Officer	A sum of Rupees Ten Thousand
33.	272BB(1)	Failed to comply with the provisions of section 203A	Assessing Officer	A sum of Rupees Ten Thousand
34.	272BB(1A)	Quote false TDS No. / TCN No. in challans/certificates/statements/documents referred to in section 203A(2)	Assessing Officer	A sum of Rupees Ten Thousand
35.	272BBB	Failed to comply with the provisions of section 206CA	Assessing Officer	A sum of Rupees Ten Thousand
36.	273	False estimate of or failure to pay advance tax	Assessing Officer	Not be less than 10% but shall not exceed one and a half times the amount by which the tax actually paid during the financial year immediately preceding the assessment year
37.	221(1)	Default in making payment of tax within prescribed period	Assessing Officer	Not more than the amount of tax in arrears
38.	158BFA	Failed to furnish return or delay in furnishing return within time specified in notice issued to file return of block period in respect of search initiated under section 132 or 132A of the Act after 31-12-1997 but before 31-5-2003.	The Assessing Officer or the Commissioner (Appeals)	Amount of tax leviable or 300% of the amount of tax leviable.
39.	140A(3)	Failed to pay self-assessed tax or interest	Assessing Officer	Not more than the amount of tax in arrears

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DIRECT TAXES

Supreme Court

Principles of Mutuality: Receipts by housing co-operative societies such as non-occupancy charges, transfer charges, common amenity fund charges and certain other charges from their members would be governed by the principle of mutuality and are not exigible to tax. The fact that the receipts are in excess of the limits prescribed by the State Government does not mean that the Societies have rendered services for profit and will not be liable for tax on attracting an element of commerciality

Income Tax Officer, Mumbai vs. Venkatesh Premises Cooperative Society Ltd. Civil Appeal No.2706 of 2018 (arising out of SLP (C) No(s). 30194/2010, dated 12th March, 2018) [2018] 91 taxmann.com 137 (SC)

1. The Supreme Court had to consider whether receipts by co-operative societies such as non-occupancy charges, transfer charges, common amenity fund charges and certain other charges from its members are exempt from income tax based on the doctrine of

mutuality. The challenge was based on the premise that such receipts are in the nature of business income, generating profits and surplus, having an element of commerciality and therefore exigible to tax.

2. The brief facts in one of the cases referred by the Supreme Court were that the respondent was a housing co-operative society, registered under the Maharashtra Co-operative Societies Act, 1960. The society fell under the category of 'tenant co-partnership housing society'. The society owned both land and building. After construction, the tenements were allotted to the members on occupancy basis in 1954.

In the year 1997-98 some unutilised FSI was utilised for the purpose of constructing four new flats on the existing building and enclosing verandahs of all the existing members. As none of the existing members had come forward to acquire new flats, the same were allotted to four new members who were duly admitted in the society. The construction of the new flats and enclosing verandahs of all the existing members was completed in the year 2001-02. However the AO was of the view that principles of mutuality could not be applicable to the amounts received from the four new members

and proceeded to assess the difference between the receipts from four new members and the construction cost of four tenements on the building of the Society as the profit from the business activity. The addition made by the AO was confirmed by the CIT(A). However, the ITAT deleted the addition holding that the principles of mutuality would apply to the amounts received from the four new members. The Hon'ble Bombay High Court dismissed the appeal of the Revenue u/s. 260A holding that the test to determine the satisfaction of mutuality (as laid down by the Hon'ble Supreme Court in Bangalore Club case) has been satisfied in the case.

3. The Supreme Court held as under:

“14. The doctrine of mutuality, based on common law principles, is premised on the theory that a person cannot make a profit from himself. An amount received from oneself, therefore, cannot be regarded as income and taxable. Section 2(24) of the Income-tax Act defines taxable income. The income of a co-operative society from business is taxable under Section 2(24)(vii) and will stand excluded from the principle of mutuality. The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund. The law envisages a complete identity between the contributors and the participants in this sense. The principle postulates that what is returned is contributed by a member. Any surplus in the common fund shall therefore not constitute income but will only be an increase in the common fund meant to meet sudden eventualities. A common feature of mutual organisations in

general can be stated to be that the participants usually do not have property rights to their share in the common fund, nor can they sell their share. Cessation from membership would result in the loss of right to participate without receiving a financial benefit from the cessation of the membership.”

After referring to the various judicial decisions the Apex Court held:

“19. The proceedings in the present appeals relate to different assessment years based on information gathered by the Assessing Officer pursuant to notice under Section 133(6) of the Income-tax Act. Transfer charges are payable by the outgoing member. If for convenience, part of it is paid by the transferee, it would not partake the nature of profit or commerciality as the amount is appropriated only after the transferee is inducted as a member. In the event of non admission, the amount is returned. The moment the transferee is inducted as a member the principles of mutuality apply. Likewise, non-occupancy charges are levied by the society and is payable by a member who does not himself occupy the premises but lets it out to a third person. The charges are again utilised only for the common benefit of facilities and amenities to the members. Contribution to the common amenity fund taken from a member disposing property is similarly utilised for meeting sudden and regular heavy repairs to ensure continuous and proper hazard free maintenance of the properties of the society which ultimately enures to the enjoyment, benefit and safety of the members. These charges are levied on the basis of resolutions passed by the society and in consonance with its byelaws. The receipts in the present

cases have indisputably been used for mutual benefit towards maintenance of the premises, repairs, infrastructure and provision of common amenities."

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

The Supreme Court further considered the provisions of the Maharashtra Co-operative Societies Act and the decision of the Bombay High Court in the case of *The New India Co-operative Housing Society vs. The State of Maharashtra*, 2013 (2)MHLJ 666 and held:

"22. In *The New India Co-operative Housing Society (supra)*, the challenge by the aggrieved was to the transfer fee levied by the society in excess of that specified in the notification, which is a completely different cause of action having no relevance to the present controversy. It is not the case of the Revenue that such receipts have not been

utilised for the common benefit of those who have contributed to the funds."

The Apex Court also took cognisance of the Notification dated 9-8-2001 which read as under:

"23. The notification dated 9-8-2001 in the relevant extract reads as follows:

ORDER: In the exercise of the powers conferred upon the State Government under Section 79A of the Maharashtra Co-operative Societies Act, 1960 following orders are hereby issued in the larger interests of the people in the State.

- 1) Xxxxxxx
- 2) *The rate of premium to be charged for the transfer Flat/Premises as well as the rights and share in the share capital/property of the Co-operative Housing Society by a member in favour of another, should be determined at the General Meeting of the Society."*

Accordingly it was held:

"24. We do not find any reason to take a view different from that taken by the High Court, that the notification dated 9-8-2001 is applicable only to cooperative housing societies and has no application to a premises society which consists of non-residential premises."

"25. Kumbakonam (AIR 1965 SC 96), is distinguishable on its own facts. The doctrine of mutuality was held to be inapplicable because the members who had not contributed to surplus as customers were nevertheless entitled to participate and receive part of the surplus. In *Chelmsford Club ((2000) 3 SCC 214)*, it was held that there was no profit motive or sharing of profits as such amongst the members. The surplus, if any, from the business was

not shared by the members but was used for providing better facilities to the members. There was a clear identity between the contributors and the participators to the fund and the recipients thereof.

“26. In the result, all appeals preferred by the Revenue are dismissed. Civil Appeal No. 1180 of 2015 preferred by the assessee society is allowed.”

The AO is not entitled to issue a reopening notice u/s. 148 of the Act merely on the basis that the foreign company has a permanent establishment (PE) in India, if the transactions in respect of which there is an alleged escapement of income, had already been disclosed by the Indian subsidiary and found by the Transfer Pricing Officer (TPO) to be at arm's length.

Honda Motor Co. Ltd., Japan, through its Authorised Representative vs. Asstt. Director of Income-Tax, Noida & Ors. Civil Appeal No(s). 2833 of 2018 (Arising out of SLP(C) No. 25363 of 2014, dated 14th March, 2018)

1. In the present case, one of the petitioners before the Supreme Court was LG Electronics Inc. In that case, the petitioner assessee was a foreign company and was engaged in the business and manufacture of sale of household electronic appliances. The petitioner had a wholly owned subsidiary company in India known as LG Electronics India Pvt. Ltd. ('LGEIPL') and had entered into several transactions relating to sale of raw materials finished goods and had received royalty income, fees for technical services, etc. These transactions had been carried out between the two companies every year since its inception. For the A.Y. 2004-05, the petitioner was in receipt of royalty and fees

for technical services of which the tax due was duly deducted and deposited. The petitioner however, did not file return of income since full tax as per the DTAA had been deducted.

2. On 24-6-2010, survey u/s. 133A was carried out on the premises of the LGEIPL. In the survey proceedings, statements of the expatriate employees of the LGEIPL were recorded. On the basis of the said statements of the expatriate employees, the AO formed a belief that income chargeable to tax had escaped assessment and notice u/s. 148 was issued to the petitioner. The reopening was based on the contention that the petitioner had a PE in India and the profits were required to be attributed to the PE in India.

3. The assessee contended that the statements of the employees had been misconstrued to form an opinion that a permanent establishment (PE) of the petitioner assessee was existing in India. It was further contended that the transactions in respect of which there was an alleged escapement of income, had already been disclosed by the LGEIPL and which had been accepted by the Transfer Pricing Officer (TPO) to be at arm's length price.

4. While deciding the case, the Allahabad High Court dealt with provisions of section 147 and also considered various judicial decisions dealing with the issue of reopening. The High Court further observed various facts involved in the case and also considered Article 5 – 'Permanent Establishment' and Article 7 – 'Business Profits' under the DTAA between India and Republic of Korea. Considering this, the High Court upheld the reopening on the following grounds and came to the conclusion as under:

- i) That there was a rational and live nexus between the reasons recorded and the belief formed by the AO that income had escaped assessment.

- ii) That once the AO came to a conclusion that the petitioner had a PE and was carrying out business activities through this PE and the PE was available to the employees of the petitioner, who were either permanently stationed or came to India for business purposes, therefore, the AO had given valid reasons to believe that income had escaped assessment.
- iii) That once a PE came into existence, which presupposed that business operations were being carried out for the purpose of profit in which case the profits or the income needed to be attributed and taxed in India and no returns were filed by the petitioner.
- iv) That the AO had tangible material to form a belief that income had escaped assessment and, consequently, rightly issued the notice under Section 148 of the Act.
- v) That the decision cited by the petitioner in the case of *G. S. Engineering and Construction Corporation vs. Deputy Director of Income Tax (International Taxation) and Others*, 357 ITR 335 was not applicable in the facts of this case."

5. On appeal by the assessee to the Supreme Court, the Apex Court reversed the decision of the High Court and allowing the appeal held:

"In the judgment of this Court dated 24th October, 2017 in Assistant Director of Income Tax-I, New Delhi vs. M/s. E-Funds IT Solution Inc., Civil Appeal No.6082 of 2015 and connected matters, it has been held that once arm's length principle has been satisfied, there can be no further profit attributable to a person even if it has a permanent establishment in India.

Since the impugned notice for the reassessment is based only on the allegation that the appellant(s) has permanent establishment in India, the notice cannot be sustained once arm's length price procedure has been followed.

Accordingly, the impugned order(s) is set aside and the appeals are allowed....."

However, the Apex Court also gave liberty to the Revenue to move the court if the factual position was different as the Revenue did not have complete instructions in the matter.

Sec. 14A/Rule 8D – For Sec. 14A(1), the "Dominant intention" theory has not been found to be acceptable and has been dismissed. Sec. 14A applies irrespective of whether the shares are held to gain control (as investment) or as stock-in-trade (for trading/business purpose). However, where the shares are held as stock-in-trade, the expenditure incurred for earning business profits will have to be apportioned and allowed as a deduction. Only that expenditure which is "in relation to" earning dividends can be disallowed u/s. 14A & Rule 8D. For the purpose of Sec. 14A(2) r.w.r. 8D, the AO has to record proper satisfaction on why the suo motu disallowance of the assessee is not correct

Maxopp Investment Ltd. vs. Commissioner of Income Tax, New Delhi [Civil Appeal Nos. 104-109 of 2015, dated 12th February, 2018]

1. The Supreme Court had to consider the question whether a disallowance under Section 14A read with Rule 8D can be made where the shares/stocks were purchased of a

company for the purpose of gaining control over the said company or as 'stock-in-trade' where incidental income was also generated in the form of dividends. Therefore, the issue to be decided by the Supreme Court was that as to whether the expenditure incurred can be treated as expenditure 'in relation to income' i.e., dividend income which does not form part of the total income. In other words, the dominant or main object would be a relevant consideration in determining as to whether expenditure incurred is 'in relation to' earning the dividend income.

2. The Supreme Court considered the provisions of the section 14A of the Act and along with the Rule 8D. It also considered the Delhi High Court decisions in the case of Maxopp Investment Ltd. and Punjab and Haryana High Court in the case of State Bank of Patiala.

3. The arguments of the assessee were recapitulated by the Apex Court as under:

- (i) The holding of investment in group companies representing controlling interest, amounts to carrying on business.
- (ii) Notwithstanding that dividend income is assessable under the head "income from other sources", in view of the mandatory prescription in Section 56 of the Act, the nature of dividend income has to be ascertained on the facts of the case. Where dividend is earned on shares held as stock-in-trade/shares purchased for acquiring/retaining controlling interest, dividend income is in the nature of business income.
- (iii) Interest paid on loans borrowed for acquiring shares representing controlling interest in the investee company is allowable business expenditure in terms of section 36(1)(iii) of the Act, since acquiring controlling interest in companies and managing, administering,

financing and rehabilitating such companies are for business and/or professional purposes and not for earning dividend.

- (iv) Conversely, interest paid on funds borrowed for investment in shares representing controlling interest does not represent expenditure incurred for earning dividend income and is not allowable under Section 57(iii) of the Act (prior to introduction of section 14A).
- (v) Section 14A was to be accorded plain and grammatical interpretation meaning thereby mandating and requiring a direct and proximate nexus/link between the expenditure actually incurred and the earning of the exempt income.
- (vi) Even if contextual/purposive interpretation is to be given, that also called for direct and proximate connection between the expenditure incurred and earning of dividend.
- (vii) The legislative intention behind inserting section 14A in the statute was to exclude both, viz., the receipts which are exempt under the provisions of the Act as well as expenditure actually incurred 'in relation thereto' from entering into the computation of assessable income.

After considering the arguments, the Supreme Court held that as per section 14A(1) of the Act, deduction of that expenditure is not to be allowed which has been incurred by the assessee "in relation to income which does not form part of the total income under this Act". If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure.

The Apex Court further held the entire dispute was, what interpretation was to be given to

the words 'in relation to' u/s. 14A. In this connection it was held that there were two scenarios to deal with, in one group of cases the main purpose for investing in shares was to gain control over the investee company. Other cases were those where the shares of investee company were held by the assessee as stock-in-trade (i.e. as a business activity) and not as investment to earn dividends. In this context, what was to be examined was whether the expenditure was incurred, in respective scenarios, in relation to the dividend income or not.

The Supreme Court held:

*"34. Having clarified the aforesaid position, the first and foremost issue that falls for consideration is as to whether the dominant purpose test, which is pressed into service by the assessee would apply while interpreting Section 14A of the Act or we have to go by the theory of apportionment. **We are of the opinion that the dominant purpose for which the investment into shares is made by an assessee may not be relevant. No doubt, the assessee like Maxopp Investment Limited may have made the investment in order to gain control of the investee company. However, that does not appear to be a relevant factor in determining the issue at hand. Fact remains that such dividend income is non-taxable. In this scenario, if expenditure is incurred on earning the dividend income, that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure.** Keeping this objective behind Section 14A of the Act in mind, the said provision has to be interpreted, particularly, the word 'in relation to the income' that does not form part of total income. **Considered in this hue, the principle of apportionment of expenses comes into play as that is the principle which is engrained in Section 14A of the Act.** This is so held in *Walfort Share and Stock Brokers P Ltd.*, relevant passage whereof is already reproduced above, for the sake of continuity of discussion, we would like to quote the following few lines therefrom:*

"The next phrase is, "in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A..... The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14A."

"35. The Delhi High Court, therefore, correctly observed that prior to introduction of Section 14A of the Act, the law was that when an assessee had a composite and indivisible business which had elements of both taxable and non-taxable income, the entire expenditure in respect of said business was deductible and, in such a case, the principle of apportionment of the expenditure relating to the non-taxable income did not apply. The principle of apportionment was made available only where the business was divisible....."

".....We, thus, agree with the view taken by the Delhi High Court, and are not inclined to accept the opinion of Punjab & Haryana High Court which went by dominant purpose theory. The aforesaid reasoning would be applicable in cases where" shares are held as investment in the investee company, may be for the purpose of having controlling interest therein. On that reasoning, appeals of Maxopp Investment Limited as well as similar cases where shares were purchased by the assessee to have controlling interest in the investee companies have to fail and are, therefore, dismissed."

On the aspect of the shares which are held as 'stock-in-trade' and not as 'investment', particularly, by the banks after considering the views in CBDT Circular No. 18/2015 dated November 2, 2015 it was held that by the Supreme Court that, income by way of interest on securities shall be chargeable to income tax under the head 'income from other sources' or it is to fall under the head 'profits and gains of business and profession. Discarding the test of dominant intention theory it was held that:

“39. In those cases, where shares are held as stock-in-trade, the main purpose is to trade in those shares and earn profits therefrom. However, we are not concerned with those profits which would naturally be treated as ‘income’ under the head ‘Profits and gains from business and profession’. What happens is that, in the process, when the shares are held as ‘stock-in-trade’, certain dividend is also earned, though incidentally, which is also an income. However, by virtue of Section 10(34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in Walfort Share and Stock Brokers P Ltd. case. Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.”

“40. We note from the facts in the State Bank of Patiala cases that the AO, while passing the assessment order, had already restricted the disallowance to the amount which was claimed as exempt income by applying the formula contained in Rule 8D of the Rules and holding that section 14A of the Act would be applicable. In spite of this exercise of apportionment of expenditure carried out by the AO, CIT(A) disallowed the entire deduction of expenditure. That view of the CIT(A) was clearly untenable and rightly set aside by the ITAT. Therefore, on facts, the Punjab and Haryana High Court has arrived at a correct conclusion by affirming the view of the ITAT, though we are not subscribing to the theory of dominant intention applied by the High Court. It is to be kept in mind that in those cases where shares are held as ‘stock-in-trade’, it becomes a business activity of the assessee to deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares

by selling them to earn profits. The situation here is, therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the assessee alone. Therefore, even at the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes up in order to earn profits.....”

“41. Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo motu disallowance under Section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.”

“43) Few appeals are filed by the Revenue against the assessee which pertained to the period prior to the introduction of Rule 8D of the Rules. Here, the case is decided in favour of the assessee also on the ground that Rule 8D of the Rules is prospective in nature and could not have been made applicable in respect of the Assessment Years prior to 2007 when this Rule was inserted. This view has already been upheld by this Court in Civil Appeal No. 2165 of 2012 (Commissioner of Income Tax, Mumbai vs. M/s. Essar Teleholdings Ltd. through its Manager), pronounced on January 31, 2018, that the said Rule is prospective in nature.”

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DIRECT TAXES

High Court

1. **S. 92 – Transfer Pricing – Most appropriate method (MAM) – where goods were customized and there were various differences CUP cannot be MAM and TNMM to be followed**

Pr. CIT vs. Amphenol Interconnect India (P.) Ltd. – ITXA 1100, 1102 & 1103 of 2015 – Bombay High Court

The assessee is a manufacturer of specialised and customised electric connectors, accessories, cable assemblies and system integrations for application in various industries such as military, aerospace and telecom etc. It manufactured against specific orders only. For the subject assessment years, the assessee entered into international transactions with its AEs. For its customised products (finished goods) to its AEs of ₹ 28.68 crore, it had applied Transactional Net Margin Method (TNMM) to determine the ALP of its exports to its AEs. The TPO accepted the TNM Method for determining the ALP of exports to the extent of ₹ 27.24 crore. The TPO, in respect of exports amounting of ₹ 1.40 crore, observed that there are similar products which assessee sold to third parties at higher prices than to the AEs. Therefore,

TPO determined the ALP by applying CUP method. On appeal, the Tribunal observed that finished goods were customised and there were various differences between the finished goods sold to third parties and those sold to AEs. These differences were in the nature of volume, geographical, timing and functional differences bearing in mind that the Assessee did not have to undertake any marketing function for sales to its AEs and after making an FAR analysis, Tribunal reversed the order of the AO. The High Court noted that the grievance as narrated by the Department was that the Tribunal order has not done necessary Functions, Assets and Risk (FAR) analysis to do the comparison as was done by the TPO. The Court held that the only grievance as urged by the Revenue is unjustified. In fact, the Court found that the TPO while stating that FAR analysis has to be carried out, does not indicate that it was carried out. On the contrary, Tribunal had done the necessary FAR analysis. This was so as it compared the risk and functional differences involved in finished goods being sold to AEs as against those sold to third parties to come to the conclusion that the prices at which the finished goods sold to the third parties were not comparables to the prices at which the goods sold to the AEs *inter alia* on the FAR analysis. The Court

noted that the view taken by the Tribunal on the facts before it, is a possible view on the application of appropriate tests. Revenue has not shown that the selection of TNM method as the MAM to determine the AL of export to AEs is perverse.

2. S. 92 – Transfer Pricing – Most appropriate method (MAM) – Commission paid to foreign agents for foreign sales cannot be compared with domestic agents for domestic sales

Pr. CIT vs. Amphenol Interconnect India (P.) Ltd. – ITXA 1100, 1102 & 1103 of 2015 – Bombay High Court

The assessee is a manufacturer of specialised and customised electric connectors, accessories, cable assemblies and system integrations for application in various industries such as military, aerospace and telecom etc. For the subject assessment years, the assessee made certain commission payments to its AEs abroad on account of sale made by them to foreign third parties. The same was benchmarked on TNMM. The TPO held that CUP method was the most appropriate method and thereby made an addition of ₹ 62.89 lakh to the income of the assessee. On appeal, the Tribunal observed that there are vast differences in the functions which are performed and the rate of commission paid by the respondent assessee to the AEs as well as to the third parties which varied from 1% to 7% depending upon the services rendered by the AEs in respect of the sales made. It found that the functions performed by the AEs for which they paid sales commission was much wider than that performed by non-AE agents. Apart from that sales commission paid on sales made in India as compared to sales commission paid to sales made abroad would have to be adjusted for geographical differences and differences in the functions

performed. As a result it was held that TNM method and not the CUP method was the Most Appropriate Method (MAM). The Court observed that Tribunal had analysed the differences between sales commission paid to its AEs for clients identified by them and the sales commission paid to third party agents in respect of sales goods in India. On account of the differences in respect of function and geography between the AEs transaction and third party transaction, the CUP method is not the MAM method. It, therefore, held that TNM method is the most appropriate. The Hon'ble High Court upheld the view of the Tribunal on the ground that the view of the Tribunal that the TNM method is the most appropriate method is a reasonable and possible view on application of appropriate test in the present facts.

3. Deduction u/s. 80-IB(10) – If the construction is as per the Development Control Regulations, the deduction u/s. 80-IB(10) has to be allowed even if the construction is not as per the approved plan

CIT vs. M/s. C. N. Builders & Developers – ITXA 1779 of 2014 – Bombay High Court

In this case, for the relevant Assessment Year (AY) 2007-08, the Assessee had claimed a deduction u/s. 80-IB(10) of the Act on certain projects undertaken by it. The said deduction was denied by the Assessing Officer (AO) on the ground that the construction is not as per the approved plan, the approved plan has commercial area more than 2,000 sq. ft. and the project was not completed by 31st March, 2008, in the sense, the final completion certificate was not received. The land was not in the name of the assessee and the approval was also not in the assessee's name. The area will be less than one acre if only the construction of certain buildings B,

C and D is considered. The same was carried in appeal by the assessee before the CIT(A) who allowed the appeal and deduction to the assessee u/s. 80-IB(10). This was also affirmed by the Tribunal against which, the Department preferred an appeal before the Hon'ble High Court. The Hon'ble High Court dismissed the Appeal holding that as long as the construction is as per the Development Control Regulations, the deduction u/s. 80-IB(10) has to be allowed even if the construction is not as per the approved plan. While coming to this conclusion the High Court fully relied on its judgment in the case of *CIT vs. Makwana Brothers P. Ltd. – ITXA Nos. 444, 452, 479, 489, 500 and 441 of 2015* wherein similar issues were dealt with by the Hon'ble High Court.

**4. Summary assessment u/s. 143(1)
(a) – Provision for bad debts
cannot be disallowance in
summary assessment u/s. 143(1)
(a) as it being a debatable issue**

Bajaj Auto Finance Ltd. vs. CIT – ITR No. 25 of 2000 – Bombay High Court

The assessee had had debited in its profit and loss account a sum of ₹ 1,69,37,818/- representing “provision for doubtful overdue installments under Hire Purchase Finance Agreements”. In its return of income, the assessee claimed the said provision as bad debts u/s. 36(1)(vii) of the Income-tax Act. In the Notes on computation of total income submitted with the return, it was clarified that the said amount was claimed as a deduction, relying on the decision of the Gujarat High Court in the case of *Vithaldas H. Dhanjibhai Bardanwala (130 ITR 95)*. The Assessing Officer disallowed the claim u/s. 143(1)(a) on the ground that the amount represented mere provision for doubtful debts and, as such, could not be treated as bad debts. The assessee filed an application u/s. 154 for deletion of the adjustment. The same was rejected by the AO on the ground that the issue of allowance of

deduction against a provision is a debatable one. The same was rejected by the CIT(A) as well as Tribunal in successive appeals. The assessee filed a reference before the Hon'ble High Court. While allowing the reference the Hon'ble High Court held that it is undisputed that the decision of Gujarat High Court was referred to in the computation of income. Thus, the Assessing Officer could not have disallowed the claim on a *prima facie* view that the same is inadmissible particularly when according to the AO himself the issue was a debatable one. The Court observed that in *Khatau Junkar Ltd. vs. K. S. Pathania 196 ITR 157* had while dealing with the word “*prima facie* inadmissible” in clause (iii) of Section 143(1)(a) of the Act, it was held that the word “*prima facie*” means on the face of it the claim is not admissible. It means the claim does not require any further inquiry before disallowing the claim. Where a claim has been made which requires further inquiry, it cannot be disallowed without hearing the parties and / or giving the party an opportunity to submit proof in support of its claim. In the absence of Section 143(1)(a) of the Act being read in the above manner i.e. debatable issues cannot be adjusted by way of intimation under Section 143(1)(a) of the Act, would lead to arbitrary and unreasonable intimations being issued leading to chaos. The Hon'ble High Court also considered the amended provisions of section 36(1)(vii) amended w.r.e.f. 1-4.1989 whereby a provision for bad debt was not allowable as a deduction permissible under the Act. However, the Hon'ble Court relying on the Judgment of the Hon'ble Supreme Court in the case of *Vijaya Bank vs. CIT – (2010) 323 ITR 166 (SC)* held that while mere making of provision for bad debts will not by itself (on application of amended law) entitle the party to deduction, yet it would be a matter where the assessee should be given an opportunity to establish its claim by producing its evidence of the manner in which it treated the provision of bad debts written off in accounts as well as in its Balance Sheet. Therefore, the disallowance

cannot be made by intimation under section 143(1)(a) of the Act, as it requires that a party be given an opportunity to establish its claim before disallowing it. It would have been a completely different matter if the Apex Court had ruled that in no case can provision for bad debts be allowed as a bad debt under section 36(1)(vii) of the Act. The allowance of the claim of provision for bad debt is entirely dependent upon how it is reflected in the Balance Sheet and its accounts. Therefore, adjustment by way of disallowing deduction by intimation under section 143(1)(a) of the Act was not proper.

5. Concealment penalty – Section 271(1)(c) of the Income-tax Act, 1961 – Denial of claim of exemption under section 10B on interest income – Not a valid ground of levy of concealment penalty. [A.Ys. 1997-98 to 1999-2000]

Cybertech Systems & Software Ltd. vs. DCIT [2018] 91 taxmann.com 407 (Bombay)

The assessee while filing the return of income claimed exemption under section 10B of the Act on the interest income also. The AO while framing the assessment order disallowed the same by observing that the interest income has no direct relationship with the assessee's business activity. The AO levied penalty on the above disallowance under section 271(1)(c) of the Act. The Tribunal observed that, the interest income stands earned on deposits placed with the bank/s for fixed term/s (FDRs) and inter corporate deposits (ICDs). It held that Assessing Officer has given a categorical finding of the interest income, which is even otherwise apparent, i.e., from the manner in which it is being derived, as having no direct relationship with the assessee's business activity and thus penalty order was justified. The assessee

filed an appeal under section 260A of the Act before the Hon'ble Bombay High Court. In the meanwhile Department issued initiated proceedings u/s. 276C, 277 r.w.s. 278B for prosecuting the assessee and its officer. The assessee filed notice of motion in the pending appeals before the High Court. The High Court admitted the penalty appeals. The High Court disposing of the notice of motions, stayed Tribunal order, by observing that the controversy in the penalty appeals in respect of deduction of interest income under Section 10B stands resolved in favour of the applicant assessee through various decisions, and at the very least, it would be a debatable issue.

6. Revision u/s. 264 – Assessee filing of revision application under section 264 instead of appeal before the Learned CIT(A) – not justified. [A.Y. 2006-07]

Nataraju (HUF) vs. Pr. CIT [2018] 91 taxmann.com 467 (Karnataka)

The assessee before the Hon'ble Karnataka High Court was a HUF. The AO while passing the assessment order for the relevant assessment year brought to tax the Long term capital gains on the sale of agricultural lands. The assessee instead of availing the appeal proceeding provided under the Act under section 246A by filing an appeal before the learned CIT(A), filed an application under section 264 of the Act before the learned Commissioner of Income Tax. However, the learned Commissioner of Income Tax dismissed the application filed by the assessee vide his order dated 27.03.2017. The assessee being aggrieved by the order of the learned Commissioner of Income Tax filed a Writ Petition before the Hon'ble Karnataka High Court. The Court observed that the fact that the revision petitions under Section 264 of the Act was filed by them within a year of passing of the impugned assessment order on 21-3-2014 namely, on 9-3.2015 and 17-3-2015, shows that the petitioners-assesseees were very

well guided about the relevant provisions of the Income Tax Act and for the reasons best known to them, they avoided the appellate remedies provided in the Act. Thus, it cannot be presumed that the petitioners-assessee being ignorant of relevant provisions of the Act, could not prefer the regular appeals before the Appellate Authorities namely, before the CIT (Appeals) or before the ITAT in due time. The Court further held that the ignorance of law is no excuse and no such presumption was prayed for. The remedy by way of a revision under Section 264 of the Act obviously lies in a narrow compass and the said remedy cannot be treated as a regular remedy bypassing the regular remedy of appeals against the impugned assessment orders and one cannot be allowed to avail the said revisional remedy under Section 264 of the Act in a routine manner bypassing the requirement of payment of tax and allowing the regular Appellate Authorities to apply their minds to the relevant facts and evidence on record.

7. Penalty u/s. 271(1)(c) – It cannot be a matter of rule that in case where court admits an appeal relating to quantum proceedings *ipso facto* i.e. without anything more, penalty order gets vitiated

Pr. CIT vs. Shree Gopal Housing & Plantation Corporation, ITA No. 701 of 2015, order dated 6th February, 2018

The Tribunal deleted the penalty levied u/s. 271(1)(c) on the ground that additions are deleted by the Tribunal in the quantum proceedings. The Revenue filed an appeal

against the Tribunal order. The Assessee stated that Revenue's appeal in the quantum proceedings had been admitted by the High Court. It was thus argued that no appeal against the order deleting penalty would lie before the Court in view of the fact that the admission of appeal in quantum proceedings by itself indicates that the question does give rise to a debatable issue. Reliance was placed on decision in case of *CIT vs. Nayan Builders and Developers [2014] 368 ITR 722 (Bombay)*. The Court held that in *Nayan Builders* no case was made out for imposition of penalty. In the said case the Tribunal had held that the disallowance of claim of deduction which has been made bona fide would not by itself lead to penalty. The Court held that each appeal in respect of order deleting / imposing a penalty by the Tribunal would have to be considered in relation to facts arising therein and also in the quantum proceedings. It cannot be said as a matter of rule that in case where the Court admits an appeal relating to quantum proceedings *ipso facto*, i.e. without anything more, penalty order gets vitiated. There can be no universal rule to the effect that no penalty if quantum appeal is admitted on a substantial question of law. The court further observed that there may be situations where admission of appeal in quantum proceedings, would be arising on pure interpretation of law or on a claim for deduction in respect of which full disclosure has been made, then there may be a possible view, that no penalty be levied as it is a debatable issue. However, there may also be cases where quantum proceedings are admitted as order may be treated as perverse, and in such cases penalty may require independent examination.

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Every man should take up his own ideal and endeavour to accomplish it. That is a surer way of progress than taking up other men's ideals, which he can never hope to accomplish.

— Swami Vivekananda



Neelam Jadhav, Keerthiga Sharma & Tanmay Phadke, *Advocates*

DIRECT TAXES Tribunal

Reported Decisions

1. Capital Gains – Section 45 r.w.s. 47(iv) of the Act – transfer of shares to the second step down 100 per cent subsidiary company does not amount to ‘transfer’ in view of the provisions of section 47(iv) of the Act

Emami Infrastructure Ltd. vs. ITO (ITA 880/Kol/2014)[Assessment Year: 2010-11] order dated 28-2-2018 [2018] 91 taxmann.com 62 (Kol.-Trib.)

Facts

The assessee is the public Limited Company and filed its return of income declaring total income ₹ 88,79,544/-. The assessee in its computation claimed the Long Term Capital Loss amounting to ₹ 25,05,20,775/- on account of sale of 2,86,329 equity shares. The learned A.O. observed that there is a huge price variation between the quoted price in NSE and the off market selling price shown by the assessee. Thus, the learned A.O., therefore, added difference in selling price under the head Long Term Capital Gains. On appeal, the learned CIT(A) confirmed the action of the learned A.O. The assessee being aggrieved by the appellate order preferred an appeal before the ITAT.

Held

The ITAT observed that the assessee sold the equity shares of M/s. Zandu Realty to M/s. Emami Rainbow Niketan Pvt. Ltd. on the basis of the price of the shares determined by SSKM Corporate Advisory Pvt. Ltd. M/s. Emami Rainbow Niketan is a 100% subsidiary of M/s. Emami Realty Ltd. M/s. Emami Realty Ltd is a 100% subsidiary of M/s. Emami Infrastructure Ltd., the assessee herein. Thus, the issue herein is whether there is a transfer of shares in view of the provisions of section 47(iv) of the Act. Section 47(iv) provides that the transfer of capital asset to its subsidiary company does not amount to transfer for the purpose of computation of capital gains as per the provisions of section 45 of the Act. Since there is no transfer, the assessee's claim that it had incurred long term capital loss and the same has to be carried forward, cannot be allowed. Similarly, the capital gain computed by the learned AO based on the fair market value computed by him and substituted for the sale consideration agreed to by the seller and buyer has to be cancelled. The ITAT while coming to the conclusion relied on the decision of the Hon'ble Bombay High Court in the case of *Petrosil Oil Co. Ltd. vs. CIT [1999] 236 ITR 220 (Bom.)* and held that the transaction in

question cannot be regarded as transfer in view of provisions of section 47(iv) of the Act, since it is a transfer of capital asset by a company to its subsidiary company. The second step down 100% subsidiary company is also a subsidiary of the assessee company under the Companies Act, 1956 as the term 'subsidiary company' has not been defined under the Income-tax Act.

2. Corpus Donation : Corpus donation given with a specific direction is a capital receipt. It is outside the scope of Section 2(24)(ia) and thus cannot be taxed in the case of trust even if it is not registered u/s. 12A or 12AA of the Act

ITO (Exemptions) Ward-2, Pune vs. Serum Institute of India Research Foundation

ITA No. 621/PN/2015, order dated 29-1-2018 (Pune ITAT), [2018] 90 taxmann.com 229 (Pune)

Facts

The assessee was registered trust under the Bombay Public Trust Act, 1950, however, it was unapproved by the CBDT as required under section 35(1)(ii) of the Act. Further, it was not registered under section 12A/12AA. The assessment year under consideration is 2005-06. During the year under consideration, the assessee received the corpus donation of Rs.3 crore which was brought to tax by the learned A.O. on the contention that the assessee has neither got the approval u/s. 35(1)(ii) nor was registered u/s. 12A/12AA of the Act. In the first round of litigation, the matter went before the ITAT which set aside the order and directed the learned A.O. to verify the contention of the assessee that the amount under consideration was received as corpus donation and in the nature of gift. Therefore, the same was not taxable. In the light of directions received by the ITAT, the learned A.O. verified the contention of the assessee and rejected the same mainly on the observation that "corpus donation" did not tantamount to exempt income as laid down

under section 2(24)(ia) of the Act. The matter went before the CIT(A). The learned CIT(A) examined the relevant provisions such as sec 2(24)(ia), sec 12A/12AA, sec 12 of the Act and allowed the claim of the assessee mainly on the observation that section 2(24)(ia) was required to be read in the context of introduction of the section 12 considering the simultaneous amendments to both the provisions with effect from 1-4-1973. Against the order of the learned CIT(A), the department went in appeal before Hon'ble ITAT.

Held

The ITAT considered sec 2(24)(ia), sec 12, sec 11(1)(d) and other relevant provisions of the Act and perused the various decisions cited by both the sides. The ITAT came to the conclusion that contention of the assessee in current case that a corpus donation with a specific direction is a capital receipt and not chargeable to tax even in the case of an unregistered trust under the Income-tax Act, 1961 is allowed in various decisions relied upon by the assessee. Further the ITAT allowed in favour of the assessee on the well-settled proposition that in case of divergent opinions, a view favourable to the assessee is required to be adopted. In view of the same, the claim of the assessee was upheld and the department's appeal was dismissed by the ITAT.

3. Registration u/s. 12AA – The trust cannot be denied registration u/s. 12AA merely because it is formed by a company to undertake a corporate social responsibility as enshrined under the Companies Act, 2013 – the registration could not be denied u/s. 12AA unless genuineness of activities of assessee-trust or its charitable object was doubted

Nanak Chand Jain Charitable Trust vs. CIT (Exemption) [ITA 6527 & 6528/Del/2016] dated 9-2-2018 (Del. ITAT) [2018] 91 taxmann.com 197

Facts

The assessee was a trust incorporated by a company to discharge its obligation towards a corporate social responsibility as enshrined u/s. 135 of the Companies Act, 2013. The object of the assessee-trust was in the nature of eradicating hunger and poverty, promotion of education etc. So, an application for grant of registration under section 12AA was filed by the assessee-trust. The CIT (Exemptions) rejected the registration u/s. 12AA of the Act mainly on the observations that the trust was incorporated merely for complying to "CSR" requirements and no activity was carried out in the trust so far. Aggrieved by the order passed by the CIT (Exemption), the assessee preferred an appeal before ITAT.

Held

The ITAT after perusing section 135 of the Companies Act, 2013 and notification dated 27-2-2014 issued by Ministry of Corporate affairs observed that "CSR compliance is allowed to be carried out through a dedicated trust or society under the Companies Act, 2013. Merely because the trust was formed for complying CSR requirements it cannot *per se* be the reasons for denying registration under section 12AA. The ITAT observed that the activities of the trust are in nature of charitable activities and held that for the purpose of granting registration under section 12AA, only two factors mainly objects of the trust and genuineness of activities are to be seen by the CIT (Exemption). All the other considerations/matters are required to be considered by a learned A.O. at the time of assessment for an exemption u/s. 11 of the Act. Further it mentioned that whether a donation is received out of profits and whether a company is eligible to claim a deduction u/s. 37 of the Act have no bearing in the hands of trust. In view of the aforesaid observations, the ITAT directed the CIT (Exemptions) to grant the registration to the assessee.

4. Registration – Section 12AA of the Act – University engaged in imparting

education is eligible for registration under section 12AA of the Act

Indus University vs. ACIT (ITA 2934/Hyd/2014) [2018] 91 taxmann.com 41 (Ahmedabad-Trib.)

Facts

The assessee is a Charitable Trust, established under the Gujarat Private University Act, 2009. The assessee is engaged in the activity of imparting education. The assessee applied for grant of registration under section 12AA. The Director of Income Tax (Exemptions) asked the assessee to file certain details and examined various provisions of the Gujarat Private University Act, 2009. The DIT(E) observed that the assessee was fully controlled by sponsoring body trust and was not independent. Further, there was intermingling of the funds, as some of it was received by the assessee and the rest by the sponsoring body trust. Based on all these reasons, the DIT(E) declined the registration to the assessee under section 12AA of the Act. Being aggrieved by the action of the DIT(E) the assessee preferred the appeal before the ITAT.

Held

The ITAT observed that the DIT(E) held that sections 41 and 42 of the Gujarat Private University Act, 2009 authorised sponsoring body to dissolve university and on such dissolution assets could be taken by sponsoring body. Since sponsored body trust was not having registration under section 12 then assets could be manipulated. This apprehension is totally misplaced and against the scheme of assessment of charitable institution provided in sections 11 to 13, though safeguards have already provided in sections 41 and 42 of Gujarat Private University Act. If a charitable institution enjoying benefit under section 12A is being dissolved then those assets would be given to other institutions being charitable trusts enjoying the benefit of section 12A/12AA as the case may be. In case assets are being parted with either an individual entity or an institution, who does not have charitable objects or registration under

section 12A, under the scheme of the Act it will first suffer tax incidence. Thereafter, it will vest in such an individual or an entity. This is not a valid reason for rejecting registration under section 12A. The ITAT while coming to this conclusion relied on the decision of the Hon'ble Punjab and Haryana High Court in the case of *CIT vs. Surya Educational & Charitable Trust [2011] 209 Taxman 53 (Pun. & Har.)*.

Unreported Decisions

5. Business Expenditure – Section 37(1) of the Act – Expenditure on account of commission to group concern is allowable since the group concern got the contract awarded to the assessee after winning the bid and the assessee duly executed contract with assistance of the said group concern

Drishti Marine Solutions Pvt. Ltd. vs. ITO, ITA No.2803/Mum/2014 dt. 20-3-2018 (Mum.)(Trib.)

Facts

The learned A.O. noticed that the assessee had debited an amount under the head "commission", further noticed that the commission had been paid to a group concern, therefore, he disallowed the same and added to the total income of the assessee stating that the assessee has made a wrong claim of the expense with a view to reduce the tax liability of the year. On appeal, the learned CIT(A) also upheld the addition stating that there is no direct evidence to show that the assessee has actually benefitted by any noticeable services provided by whom the commission was paid. There is no clarity on the calculation of commission because initially it was claimed as commission on purchases whereas later on the appellant changed its stand to claim that commission was paid on the projected receipts for three years. Generally commission was not paid in advance in anticipation of projected sales in subsequent years which have also not materialised in the

year. Being aggrieved by the appellate order assessee preferred the appeal before ITAT.

Held

The ITAT held that the group concern has got the contract awarded to the assessee company after winning the bid, the same was a huge service in itself. The group concern has provided its expertise in handling the large amount of purchases and other services in this case. If the group concern had huge losses and it wanted to adjust profits it could have very well executed the contract itself the bid which it had won. Whereas the assessee has duly executed the contract with the assistance of the group concern therefore the sums paid as consideration/commission to the group concern cannot be said to be a colourable device and the same is allowable as an expenditure in the hands of the assessee.

6. Cash credit – Section 68 of the Act – the assessee substantiated the entire transaction by providing various details and explanations – the addition u/s. 68 of the Act is unsustainable

ITO vs. M/s. Neclous Steel Private Limited ITA No. ITA.No.369/Del/2015, order dated 23-3-2018 (Del. - Trib.)

Facts

The learned A.O. noticed that the assessee showed a fresh sundry creditor under the head "Current Liabilities". The learned A.O. while completing the assessment, treated the same as unexplained credit. The learned A.O. noted that the assessee received an advance from "M" as against the sale of land in Maharashtra. The Agreement to sell was executed on 10th March, 2010 between the parties. The agreement to sell was made on Non-Judicial Stamp paper on 12th March, 2010. The stamp paper was issued to "M" on 3rd March, 2010 and further noted that the stamp paper was issued by the Delhi Treasury on 22nd March, 2012 i.e., two years after the date of execution. Further the valuation of property

was found at a lesser amount. In view of the said observations, the learned A.O. doubted the entire transaction and made the addition u/s. 68 of the Act. On appeal, the learned CIT(A) accepted the contention of the assessee and allowed the appeal. The Department being aggrieved by the appellate order preferred the appeal before the ITAT.

Held

The ITAT observed that the transaction was duly substantiated by the assessee. The assessee apart from the creditor directly confirmed the transaction with the assessee filed confirmation of the creditor, the affidavits, and ITR acknowledgements with balance sheet which proved the identity, creditworthiness and genuineness of the transaction. Further the amount in question was received through the banking channel and all the corresponding entries were recorded in the books of the assessee as well as creditor. The assessee further clarified about an inadvertent mistake in mentioning the date of the agreement. In the light of the same, the ITAT confirmed the order of the CIT(A) and dismissed the appeal filed by the department.

7. Notice – Section 143(2) of the Act – the assessment in itself is bad in law when the notice under section 143(2) is issued beyond the limitation by the A.O. who has no jurisdiction

ITO vs. M/s. NVS Builders Pvt. Ltd. (ITA 3729//Del/2012)[Assessment Year: 2006-07] order dated 8-3-2018

Facts

The assessee is the Private Limited Company and filed its return of income on 20-11-2006 declaring income at ₹ Nil. The return was selected for scrutiny assessment. The ITO ward 1(1), Faridabad issued a notice dated 23-10-2007 under section 143(2) of the Act. In response to the said notice, the assessee filed its reply and submitted that the ITO, Faridabad did not have

jurisdiction over the assessee since the returns for earlier and subsequent years were filed in Delhi. Thereafter, the ITO 1(1), Faridabad transferred the file to the ITO 10(1), New Delhi. The ITO 10(1), New Delhi, then, issued a notice dated 28-7-2008 under section 143(2) of the Act and passed the assessment order dated 30-12-2008. Being aggrieved by the said assessment order, the assessee preferred the appeal before the learned CIT(A). During appellate proceedings the assessee challenged the service of the notice under section 143(2) since the same was beyond the limitation period. Before learned CIT(A), the assessee contended that the notice under section 143(2) was issued by the ITO – 1(1), Faridabad who had no jurisdiction over the assessee. The assessee, further, explained that the notice issued by the ITO 10(1), Delhi is beyond the limitation period of 19 month as provided under the Act. Thus, the assessment completed under section 143(3) of the Act is null and void. The learned CIT(A) after considering the submissions of the assessee allowed the appeal. The department being aggrieved by the appellate order preferred the appeal before the ITAT.

Held

The ITAT observed that the return of income had been filed on 20-11-2006 before the ITO at New Delhi who has jurisdiction over the assessee. However, the notice dated 23-10-2007 was issued by the ITO, Ward-1(1), Faridabad who did not have jurisdiction over the assessee. The ITO, New Delhi, thereafter, issued the notice under section 143(2) on 28-7-2008, which was beyond the period prescribed under the Act. It is, therefore, clear that the learned A.O. having jurisdiction over the assessee did not issue the notice under section 143(2) within the period of limitation provided under the Act. Therefore, the first notice issued by ITO, Ward-1(1), Faridabad, having no jurisdiction over the case of the assessee would not be valid and would not get any jurisdiction over the assessee. Since the issue is about the violation of the jurisdictional requirement, the internal procedure provided by

the department would not justify the illegality committed by the ITO, Ward-1(1), Faridabad. Thus, the entire assessment proceedings are vitiated because of non-service of jurisdictional notice under section 143(2) within the period of limitation by the A.O. who has jurisdiction over the assessee. Therefore, the ITAT confirmed the finding of facts recorded by the learned CIT(A) and dismissed the appeal of the Revenue.

8. Unexplained cash credit – section 68 – Once the assessee furnishes basic details like PAN, bank statements, ITR acknowledgement of share applicants, the learned A.O. is free to proceed against the share applicants and cannot tax the share application money in the hands of the assessee company as undisclosed income. A proviso to section 68 inserted by Finance Act, 2012 is prospective and the issue of high share premium cannot be taxed prior to its applicability

Dy. CIT- 1(1)(1), Mumbai vs. Ms. Alcon Biosciences Pvt. Ltd. [ITA 1946/Mum/2016] (Assessment Year: 2009-10)

Facts

The assessee is a private limited company and engaged in the business of manufacturing, trading and exporting pharmaceutical items. The Assessment Year is 2010-11. During the course of assessment proceedings for the year under consideration, the learned A.O. noticed that the assessee had received share application money of ₹ 1.15 crore from 3 parties and asked the assessee to furnish relevant details and the same were furnished by the assessee. To verify the genuineness, the learned A.O. issued notices u/s. 133(6) to all the three parties which were returned unserved since the parties refused to accept. Thereafter, the learned A.O. issued a notice to assessee's banker (i.e. Bank of Baroda) asking to give details of the said share application money. The bank provided the details of credits made to the assessee's account. On the basis of the same,

the learned A.O. issued a notice u/s. 133(6) to the banker of all three share applicant and received the information. The learned. A.O. observed that the bank accounts were operated for a limited period and also those bank accounts received money from some individuals. In view of the said facts, the learned A.O. made the addition of the same u/s 68 of the Act. The assessee preferred an appeal before the CIT(A) and reiterated his submission. The CIT(A) after examining the details and relying upon the decision of Hon'ble Apex Court in *CIT vs. Lovely Export Ltd.* deleted the addition made by the learned A.O. Against the said order, the department filed an appeal before ITAT.

Held

The ITAT observed that the assessee had filed the details like share application money, incorporation certificate, bank statements of the share applicant. Further the assessee furnished an ITR acknowledgement by one of the applicants and could not file with regard to remaining two parties since the returns were not filed by them. However the assessee furnished a copy of bank statement, PAN with regard to remaining two applicants. The ITAT observed that once the assessee furnished all the above-mentioned details, the initial burden cast on it was discharged and thereafter the burden shifts to the revenue to prove otherwise. The ITAT observed the learned A.O. did not prove otherwise. The ITAT relying on the decisions of *Lovely Export (SC)*, *CIT vs. Gagandeep Infrastructure Pvt. Ltd (Bom HC)* and *CIT vs. Paradise Inland Shipping Pvt Ltd. (Bom HC)* held that the learned A.O. is free to proceed against the share applicants when the assessee furnished all the details but cannot be taxed the said share application money in the hands of the assessee as undisclosed income. The ITAT further observed that the learned A.O. cannot question the issue of shares at a premium and cannot bring to tax such premium u/s 68 of the Act before insertion of proviso to sec 68 by the Finance Act, 2012 which is prospective as held by Hon'ble Bombay High Court in case of *CIT vs. Gagandeep Infrastructure Pvt. Ltd.* In the light of the aforesaid observations, the appeal filed by the department was dismissed.

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CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION

Case Law Update

A. SUPREME COURT RULINGS

1. Where the transfer pricing addition made in the final assessment order pursuant to original assessment proceedings was set aside to the Assessing Officer to consider fresh evidence filed by the assessee, the Assessing Officer was obligated to first pass a draft assessment order under Section 144C of the Act prior to passing a final assessment order, failing which the final assessment order under Sections 143(3)/254 read with Section 144C(13) of the Act and consequential demand notice issued under Section 156 of the Act are liable to be set aside / quashed

DCIT vs. Control Risks India Pvt. Ltd. – TS-170-SC-2018-TP – Special Leave Petition – 7090 / 2018

Facts

1. The assessee was engaged in the business of providing consultancy services. For the year under review i.e. AY 2011-12, the Assessing Officer passed a draft assessment order proposing a transfer adjustment as well as an adjustment on account of disallowance of interest paid on late deposit of TDS, which was

confirmed by the DRP, pursuant to which the Assessing Officer passed a final assessment order under Section 143(3) read with Section 144C of the Act.

2. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal and filed certain fresh evidences, pursuant to which the Tribunal remitted the matter to the TPO to consider the additional details filed by the assessee and to pass a speaking order upon such consideration.

3. The TPO undertook a fresh benchmarking analysis and proposed an adjustment to the arm's length price determined by the assessee.

4. Thereafter, instead of passing a draft assessment order, the Assessing Officer passed a final assessment order under Sections 143(3) / 254 read with Section 144C and also issued a consequential notice of demand under Section 156 of the Act.

5. Aggrieved, the assessee filed a Writ Petition before the Hon'ble Delhi High Court. The Hon'ble High Court observed that it was incumbent on the Assessing Officer to pass a draft assessment order under Section 144C of the Act prior to passing a final assessment order. Noting that by directly passing a final assessment order, the Assessing Officer had denied the assessee of an opportunity of approaching the DRP and relying on the decision of the Co-ordinate Bench in *Turner International*

India Pvt. Ltd. vs. DCIT (2017) 82 taxmann.com 125 (Del.) set aside the assessment order and quashed the notice of demand.

6. Aggrieved, the Revenue filed an SLP before the Hon'ble Apex Court.

Held

The Hon'ble Apex Court dismissed the Revenue's SLP.

B. AUTHORITY FOR ADVANCE RULINGS

2. Non-resident availing the benefit of the first proviso to Section 48 was entitled to the benefit of lower tax rate of 10 per cent under the first proviso to Section 112 of the Act

Finnish Fund for Industrial Cooperation Ltd. – TS-110-AAR-2018 – AAR No. 1375 of 2012

Facts

1. The Applicant, a company registered in Finland was a non-resident under the provisions of the Act. It was a development finance company and provided long-term risk capital for private projects. It did not actively trade in stocks of Indian companies but pursued a long-term growth oriented strategy. It had acquired 21,25,005 shares of Andhra Pradesh Paper Mills Ltd. ('APPML'), a listed company and subsequently sold the shares either on the stock exchange or pursuant to an open offer from a company named IP Holdings as a result of which it earned long term capital gains of ₹ 32.64 crore. The Applicant filed an application under Section 197 of the Act for determining the rate of tax to be withheld on the impugned capital gains and pursuant to the order of the Assessing Officer, IP Holdings withheld tax at 21.02 per cent on such long term capital gains.

2. The Applicant raised the following question before the AAR:

"Whether the tax on the long term capital gains earned by the Applicant on sale of shares of

Andhra Pradesh Paper Mills Ltd. an Indian listed company, pursuant to an open offer, is required to be computed at 10.506% as per the proviso to Section 112(1)?"

Held

1. The AAR dismissed the contention of the Revenue that since the assessee was a non-resident, the first proviso to Section 48 of the Act would apply and consequently the second proviso to Section 48 (providing for the benefit of indexation) would not apply and therefore the non-resident was liable to tax at 21.02 per cent and the benefit of the first proviso to Section 112(1) would not apply.

2. The AAR accepted the contention of the Applicant that the entire issue was squarely covered by the decision of the High Court in *Cairn UK Holdings vs. DIT [359 ITR 268]* wherein it was held that as per a literal interpretation, the proviso to Section 112(1) of the Act does not state that a person availing the benefit of the first proviso (as so in the Applicant's case) was not entitled to avail the benefit of lower tax @ 10 per cent under Section 112 of the Act. Accordingly, it held that the long term capital gains on sale of shares to APPML under the open offer would be taxable at the rate 10.506% (inclusive of surcharge and cess) under the proviso to Section 112(1) of the Act.

C. HIGH COURT

3. The Court upheld Tribunal's order excluding 6 companies from the list of comparables on account of high brand value, functional difference and inadequate segmental results

Pr CIT vs. Evalueserve SEZ Pvt. Ltd. – TS-125-HC-2018(DEL)-TP-ITA No. 241 / 2018 – Delhi High Court

Facts

1. The assessee was engaged in the business of providing IT enabled services i.e. provision

of business information, market research and intellectual property research to its AEs and benchmarked its international transactions under TNMM.

2. The TPO conducted the exercise of determination of ALP afresh and arrived at 10 comparables.

3. Aggrieved with the inclusion of 6 of the comparables viz. TCS E-Serve Ltd., TCS-E Service International Ltd., Infosys BPO Ltd., Accentia Technologies Ltd., ICRA Techno Analysis Ltd. and Eclerx Services, the assessee filed objections before the Hon'ble DRP. The DRP rejected the assessee's contentions and confirmed the draft assessment order.

4. The Tribunal accepted the assessee's plea and directed the exclusion of the six comparables.

5. Aggrieved, the Revenue filed an appeal before the Hon'ble Court.

Held

1. Vis-à-vis the Tribunal's exclusion of TCS E-Serve Ltd., TCS E-Serve International Ltd. and Infosys BPO Ltd., the Court following the decision of the Co-ordinate Bench in *Pr CIT vs. BC Management Services Pvt. Ltd. – 89 taxmann.com 68 (Del.)* held that the Tribunal had correctly excluded the said companies as these entities had a high brand value as compared to the assessee and were therefore able to command greater profits and also since they operated on economic upscale.

2. As regards Accentia Technologies Ltd. it held that the Tribunal had rightly excluded the said company as comparable as it was engaged in providing various activities and did not have adequate segmental results.

3. Further, it upheld the exclusion of ICRA Techno Analysis observing that the company was functionally dissimilar to the assessee it was engaged in providing business intelligence, software development, consultancy services, engineering services, web development and

hosting services and did not have adequate segmental results.

4. It held that Eclerx was also rightly excluded by the Tribunal as it performed KPO services whereas the assessee was a BPO.

5. Observing that no substantial question of law arose, it dismissed the Revenue's appeal.

4. Infosys BPO Ltd. could not be considered as comparable owing to its huge brand value. R Systems Ltd. could not be excluded merely because it followed a different financial year ending where the results of the relevant financial year could be reasonably extrapolated from the data available on record

Pr CIT vs. MMTCL Ltd. – TS-135-HC-2018(DEL)-TP - ITA No. 260 / 2018 – Delhi High Court

Facts

1. The assessee was engaged in the business of providing ITES and benchmarked its transactions under TNMM. The TPO carried out his own search and included various comparables out of which the assessee was aggrieved with the inclusion of three comparables i.e. TCS E Serve Ltd., Infosys BPO Ltd. and Excel Infoways Ltd. The TPO also excluded R Systems as comparable

2. On appeal, the Tribunal accepted the plea of the assessee and directed exclusion of the three companies and the inclusion of R Systems.

3. Aggrieved, the Revenue filed an appeal before the Hon'ble Court

Held

1. Vis-à-vis the exclusion of Infosys BPO and the inclusion of R Systems, the High Court held that no substantial question of law arose. Relying on the decision of the Co-ordinate Bench

in Baxter India Pvt. Ltd. ITA 408/2017, it held that Infosys BPO was rightly excluded as it had huge brand value. As regards R System, the Court relying on its decision in *CIT vs. McKinsey Knowledge Centre Pvt. Ltd. ITA 217 / 2014* held that the company could not be excluded merely on account of different financial year ending where the financial data for the year could be reasonably extrapolated from the data available on record. Accordingly, it dismissed the appeal of the Revenue.

2. It admitted the Revenue's appeal vis-à-vis the Tribunal's exclusion of TCS E Serve Ltd. and Excel Infoways.

D. TRIBUNAL DECISIONS

5. As per Article 5(5) for determining the independence of an agent one should only look at the whether the agent has only one principal for whom it works for exclusively and the fact that the principal has only agent in India would not be relevant

ADIT (IT) vs. Bay Lines (Mauritius) – (2018) 91 taxmann.com 110 (Mum.-Trib.) – ITA No. 1181 / Mum. / 2002

Facts

1. The assessee, a shipping company incorporated in Mauritius claimed 100 per cent relief under Article 8 of the India-Mauritius DTAA, in support of which it furnished a Tax Residency Certificate issued by the authorities of Mauritius.

2. The Assessing Officer denied the assessee relief under Article 8 observing that the place of effective management was in the UAE and not in either India or Mauritius and therefore the provisions of the India-Mauritius DTAA would not be available to the assessee. The AO noted that i) two of the assessee's directors who took majority of the decisions were situated in UAE, ii) the main agent of the assessee in India was

appointed on the letter head of the assessee at UAE and iii) the letter to the AO by the assessee also originated from UAE, Dubai. Accordingly, it held that the place of effective management of the assessee was in the UAE and therefore was not eligible to the India-Mauritius DTAA. Further, the AO noted that the assessee had an agent in India viz. FCIPL which was doing all the work in all the Indian ports and habitually concluded contracts on behalf of the assessee and therefore held that the assessee had a Dependent Agent Permanent establishment in India.

3. On appeal to the CIT(A), the CIT(A) upheld the AO's findings vis-à-vis the non-availability of deduction under Article 8 of the DTAA. However, it held that the AO erred in holding that the assessee had a DAPE in India and observed that FCIPL only earned 57.95 per cent of its total commission from the assessee whereas 42.05 per cent of the commission earned by it was from other parties which proved that FCIPL was not the exclusive agent of the assessee. Accordingly, it held that the assessee was not liable to tax in India.

4. Aggrieved, both the assessee and the Revenue filed appeals before the Hon'ble Tribunal

Held

1. Vis-à-vis the existence of DAPE, the Tribunal, relying on the decision of the Bombay High Court in *DIT vs. B4U International Holdings Ltd. 374 ITR 453 (Bom.)*, dismissed the contention of the Revenue that since the assessee had only one agent in India viz. FCIPL, FCIPL constituted a DAPE of the assessee and held that as per Article 5(5) for determining the independence of an agent one should only look at the whether the agent has only one principal for whom it works for exclusively and the fact that the principal has only agent in India would not be relevant.

2. Vis-à-vis the applicability of Article 8 of the DTAA, the Tribunal dismissed the contention of the assessee that the effective place of management could only be in one of the two contracting States and relying on the

commentary of Dr. Klaus Vogel held that where the effective place of management was not in either of the contracting States, the benefit of Article 8 of the DTAA could not be extended to the assessee.

6. Opportunity of hearing before referring the matter to TPO was to be read into Sec. 92CA(1) where the very jurisdiction to tax under Chapter X was challenged by the assessee

Omni Active Health Technologies Ltd. vs. DCIT – TS – 146- ITAT-2018 (Mum.) – TP - ITA No. 638 / 2017

Facts

1. The assessee, Omni Active Health Technologies Ltd. was engaged in the manufacture and supply of natural ingredient products to its AE. Occasionally, it also sourced raw material from third parties based in USA. Since its AE was situated in the USA, such sourcing was done via AE and who charged the assessee on cost-to-cost basis. During the year the assessee imported raw material via its AE amounting to only ₹ 1.03 crore and finished goods of ₹ 7.56 lakh which was miniscule as compared to overall volume of assessee's business. Thus, both its international transactions i.e. export of goods to AE as well as import of materials from AE were clubbed together and benchmarked under Transitional Net Margin Method (TNMM).

2. The TPO inferred that the assessee sold the goods at a much lower rate to the AE vis-a-vis non-AE entities. Accordingly, rejecting the application of TNMM (even though it was followed and accepted by the Revenue in the prior years), the TPO applied CUP method as MAM and proposed an adjustment of ₹ 13.42 crore, which was confirmed by the DRP.

3. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal. Further, it raised an additional ground that that AO's action of

making reference to TPO without giving any opportunity of being heard to the assessee, was in violation of the provisions of Sec. 92CA of the Act and thus the reference and order ought to have been quashed.

Held

1. The Tribunal observed that in the decision of the Bombay High Court in *Vodafone India Services P. Ltd. [TS-320-HC-2013(BOM)-TP]*, the Court had held that the grant of opportunity of hearing before referring the matter to TPO was to be read into Sec. 92CA(1) where the very jurisdiction to tax under Chapter X was challenged by the assessee and that where no objection was raised by the assessee to the applicability under Chapter X, then the *prima facie* view of the AO would be sufficient before referring the matter to the TPO for ALP determination. Further, it also referred to CBDT Instruction No. 15 of 2015 which enumerated 3 situations, where the AO must, as a jurisdictional requirement, record his satisfaction that there was an income or potential of an income arising and/or being affected on determination of the ALP of an international transaction before he proceeded to determine the ALP. Noting that the assessee neither challenged the applicability of Chapter X nor contended that the AO had not recorded requisite satisfaction, the Tribunal dismissed the assessee's additional ground of appeal.

2. Vis-à-vis the merits of the case, the Tribunal held that the TPO had rejected the consistently applied TNMM method without bringing on record any cogent reason. It held that Section 92C did not provide for an order of preference of method for determining arm's length price and therefore considering that the TNMM method was accepted to be the MAM in the past, there was no justification in applying CUP for the year under review. Noting that the PLI of the assessee came to 15.21% which was higher than the PLI of the 2 comparable companies, the Tribunal deleted the TP adjustment.





Harsh Shah, *Advocate* & CA Gourav Sogani

INDIRECT TAXES GST Gyan

Affordable Housing made more affordable

The Indian Real Estate market is expected to touch US \$ 180 billion by 2020¹. This sector also contributes to the economy on account of number of services that are consumed in relation to construction and real estate development. As per 2011 census data, India's urban population increased at a compound annual growth rate (CAGR) of 2.8% over 2001-11, resulting in an increase in the urbanisation rate from 27.8% to 31.2% during the same period. Increasing population and rapid urbanisation resulted in a significant shortage of housing across cities in India. In this context, the Centre and State Governments acknowledged the importance of accommodating the growing population with acceptable standards of living, and announced many policies, schemes and regulations. Further, on account of the slowdown in the Real Estate sector post the 2008 financial crisis there are instances of stalled projects from that period. Realising the mismatch between the need of the larger mass and the available inventory, the Government announced the Housing for All by 2022 in June, 2015. Ever since then, the affordable housing segment is literally the talk

of the town, with billboards hailing the virtues of upcoming residential projects splashed across cities.

It is also a well-known fact that the implementation of Goods and Services Tax ('GST') effective July 1, 2017 has not been an easy walk for Real Estate sector. There were several issues such as taxation of Development Rights, treatment of GST on cancellation of flat, etc. which lacked clarity. However, the Government has continued its commitment towards Housing of All by 2022 and accordingly has been notifying various beneficial measures to achieve this mammoth goal.

Initially, the Government notified certain affordable housing schemes eligible for concessional rate of GST @ 12% *vide* Notification No. 20/2017 Central Tax (Rate) dated 20th August 2017 (as amended from time to time 'Original Notification'). It may be interesting to know that these were the same schemes which were part of the mega exemption notification under the Service Tax Regime. Thus, one change on account of implementation of GST is clearly

¹ Estimate as per India Brand Equity Foundation

moving from exemption to taxability, albeit at a lower rate. However, there were very selective housing schemes to which the benefit of lower rate of tax was available.

After a lot of hue and cry from the industry players and several representations made by various bodies, in the 25th GST Council meeting held on January 18, 2018, a recommendation was made to expand the housing projects to which the benefit of lower rate of GST would be available. Based on the recommendation of the GST Council, the Government amended the Original Notification to extend the benefit of concessional rate of GST to units having carpet area up to 60 sq. mtr. in an affordable housing project which has been given infrastructure

status as defined under Notification F. No. 13-6-2009-INF dated 30-3-2017 issued by the Department of Economic Affairs [DEA Notification] (Notification No. 01/2018 Central Tax (Rate) dated 25-1-2018 [‘Notification’]). Necessary amendment was also incorporated in Paragraph 2 of the Original Notification to extend the abatement towards land for the units sold under the various notified affordable housing projects, which involves transfer of land. This eventually resulted in the effective rate of GST @ 8% for such units. The said entry in the Notification bought the major and much needed relief to the Real Estate sector and at this stage seems to be one of the prodigious steps by the Government towards reaching its target of Housing for All by 2022.

The relevant extract of the Notification is as follows –

<i>Description of Service</i>	<i>Rate (%)</i>	<i>Conditions</i>
3	4	5
<p><i>(v) Composite supply of works contract as defined in clause (119) of section 2 of the Central Goods and Services Tax Act, 2017, supplied by way of construction, erection, commissioning, or installation of original works pertaining to, –</i></p> <p><i>(a)...(d)</i></p> <p><i>(da) low-cost houses up to a carpet area of 60 square metres per house in an affordable housing project which has been given infrastructure status vide Notification of Government of India, in Ministry of Finance, Department of Economic Affairs vide F. No. 13/6/2009-INF, dated the 30th March, 2017</i></p>	6%	

(Note: Similar Notification has been issued by the State Authorities under Maharashtra Goods and Services Tax Act, 2017)

On a holistic reading of Entry (v)(da) (“Entry”) of the Notification, it can be observed that all of the following conditions are required to be fulfilled in order to become eligible for concessional rate of GST (12% or 8%, as the case may be) –

- i. Composite supply of works contract by way of construction, erection, commissioning or installation of original works
- ii. Low cost house up to carpet area of 60 sq. mtrs.

- iii. Part of an affordable housing project having infrastructure status as defined in the DEA Notification

We now examine each of the above conditions in detail to understand the requirements in order to avail the benefit of reduced rate of GST.

- I. Composite supply of works contract by way of construction, erection, commissioning or installation of original works**

The word 'original works' appears in almost all the entries added to Serial No. 3 of the Original Notification. However, 'original works' has not been defined in the Central Goods and Services Tax Act (CGST Act) and Rules made thereunder or in the Original Notification or any subsequent Notification which amended the Original Notification. A possible interpretation to the said term can be derived by relying on the definition provided in the Service tax (Determination of Value) Rules, 2006 wherein it included construction as one of the activities qualifying as 'original works'. Further, if one reads the various entries of Serial No. 3, it seems that the intention of the legislature seems to continue with the similar interpretation even under the GST Regime. Therefore, one may be able to take a view that construction activity will get covered under the term 'original works' specified in the Entry.

II. Low cost house up to carpet area of 60 sq. mtrs.

Similar to 'original works' the term 'low cost house' (LCH) has not been defined. If one reads into the Entry, it is aptly clear that the term is of wide importance and therefore it is necessary to arrive at a logical interpretation of the term 'LCH'. Considering the fact that the only requirement under this condition seems to be linked with the size of the unit, a unit with carpet area of 60 sq. mtr. may be treated as LCH for the purpose of the Entry.

The key concern with such interpretation is ignoring the relevance of the term 'cost' used in LCH. Assuming a unit which fulfil the size criteria but is highly expensive because of the location of the Project, would it still qualify as LCH? Such construal will effectively result in disregarding the significance of the word 'cost' in LCH. However, in absence of any specific reference / definition and on the overall reading of the Entry, the most reasonable meaning seems to be based on the size of the unit as specified in the Notification. Having said that, it is pressing

to have a proper definition in place in order to have clarity in respect of the term 'LCH' and thereby avoiding future litigations.

III. Part of an affordable housing project having infrastructure status

This is the most critical condition of the Entry and is effectively the deciding factor for eligibility to avail the reduced rate of GST. The condition requires a Project to form part of an affordable housing having infrastructure status in terms of the DEA notification to avail the benefit of reduced rate of GST.

In terms of the DEA Notification, a housing project with at least 50% of Floor Area Ratio (FAR) / Floor Space Index (FSI) used for the construction of units having carpet area of less than 60 sq. mtrs. will qualify as an affordable housing project to which infrastructure status is available. The relevant extract of the DEA Notification is reproduced below –

"Affordable Housing" is defined as a housing project using at least 50% of the Floor Area Ratio (FAR)/ Floor Space Index (FSI) for dwelling units with carpet area@ of not more than 60 square metres.

"Carpet Area" shall have the same meaning as assigned to it in clause (k) of section 2 of the Real Estate (Regulation and Development) Act, 2016."

Unfortunately, the issue of interpretation of the terms used therein still continues. The DEA Notification refers to a housing project where 50% FSI / FAR is being used for the houses with size up to 60 sq. mtrs. of carpet area. Hence the centre of the said condition is the term 'Project' which is undefined and ambiguous. Therefore the difficulty which is being faced by a Developer intending to avail the benefit is to construe the term 'Project'.

The Developer is required to approach the Municipal Authorities with the plan for the land parcel on which he intends to undertake construction activity. Generally, the Developer

submits a single plan for the entire land parcel as one project for various commercial and technical reasons. Such a Project may constitute of different buildings, towers and / or phases. However, the Developer may take up the construction of a single building, tower or phase taking into account various other parameters such as demand-supply gap, availability of funds etc. Consequently, the Project for commercial and marketing purpose may be different from the Project sanctioned by the Municipal Authorities. Also, after introduction of Real Estate (Regulation and Development) Act, 2016 (RERA), the governing statute for real estate projects, it is mandatory for the Developer / Promoter to register with RERA before initiating marketing and selling the units in the Project. RERA provisions also specify various information / compliances to be fulfilled in respect of the Project registered with RERA. However, considering the manner in which a Project has been defined under RERA and depending on the approach adopted by the Developer, even a building / tower / phase may be treated as separate real estate project and the compliances, cashflow etc. will be required to be fulfilled and monitored accordingly. Therefore, the Project sanctioned by Municipal Authorities may be different than the Project as per RERA. This adds to the confusion of interpreting the word Project since it could have different meaning for different purposes.

The calculation of 50% of FSI / FAR needs to be done *qua* the Project which can have different meaning unless specifically defined. Therefore, in order to avail the benefit of concessional rate

under the Entry, it is imperative to arrive at a logical and appropriate interpretation of the word 'Project' used in the DEA Notification. One could consider taking recourse to the dictionary meaning, common parlance test or reliance on the definition provided in other Act / Statute. Further, keeping in mind the objective of the Notification and other relevant facts, one may take recourse to RERA definition considering the fact that it is the authority formulated to regulate real estate sector. However, since there is no specific definition of the term 'Project', this is an area where one can possibly expect litigation in the coming days.

Another concern running around the Notification is 'Infrastructure Status' of the Project. The apprehension is, whether the Developer is required to approach the Department of Economic Affairs for a formal communication before availing the benefit under the Notification. However, the language of the Notification and DEA Notification do not suggest any other requirement which a Project requires to fulfil to qualify for Infrastructure Status

On a whole, this is a welcome amendment for the Sector which is severely affected due to various other economic reasons. The amendment will probably take the Government closer to its objective of Housing for All. However, any delay in providing the clarification of the above-mentioned undefined terms used in the Notification and DEA Notification will defeat the real objective of the amendment and may eventually result in unnecessary litigation.

□□□

Honesty is the best policy, and a virtuous man must gain in the end.

— Swami Vivekananda



CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES

GST – Legal Update

NOTIFICATIONS

Central Goods & Services Tax (CGST)

Second Amendment (2018) to CGST Rules (Notification No. 12/2018 dt. 7-3-2018 and Order No. 1/2018 dated 28th March 2018)

Vide Notf. No. 12/2018-CT dt. 7th March, 2018, due date for Form GST TRAN-2 was provided as 31st March, 2018 or within such period as extended by the Commissioner. Now, *vide* Order No. 1/2018 dt 28th March 2018, the period is extended till 30-6-2018.

Amendment to E-Way bill provisions (Notification No. 12/2018 dt. 7-3-2018, 15/2018 dt. 23-3-2018, Press Release dt. 10-3-2018 & Press Release dated 31-3-2018)

- E-Way bill Rules viz. Rule 138 (except clause 7), 138A, 138B, 138C, 138D shall come into force w.e.f. 1-4-2018 for inter-state supplies.
- Explanation 2 added to Rule 138(1) to exclude the value of exempt supply while calculating the limit of ₹ 50,000/- for applicability of E Way Bill Rules.
- Rule 138(2A): for transport of goods by railways, air or vessel, the e-way bill may

be generated before /after commencement of movement of goods. Also, in case of transport by railways, delivery by railways will take place only if e-way bill is produced at the time of delivery.

- 3rd proviso to Rule 138(3) amended to exempt distance up to 50km (previously 10km) from furnishing details in Part B where goods are transported (within the state /UT from the place of consignor to the place of transporter for further transportation.
- Rule 138(5) amended to extend the option to update details in Part B of Form EWB-01 also to the consignor or recipient, in case goods are transferred from one conveyance to another. If the distance from the place of transporter to the place of business of consignee is up to 50km within the state / UT amendment not required.
- Rule 138(5A) added to provide that consignor, recipient or the transporter may assign e-way bill number to another registered/enrolled transporter for updating information in Part B for further movement of goods.
- Rule 138(7) is amended to exclude transport by railways, air and vessel from

generation of e-way bill by transporter if not generated by consignor or consignee. It is further provided that in case of supply through e-commerce operator or courier agency, information in Part A of EWB-01 may be furnished by such e-commerce operator or courier agency.

- Second proviso added to Rule 138(9) to provide that the unique no. generated shall be valid for 15 days for updation of transporter details in Part B of EWB-01.
- Validity of e-way bill amended as under:

<i>Distance</i>	<i>Validity Period</i>
Up to 100 km	1 day in cases other than Over Dimensional Cargo
For every 100 km or part thereof thereafter	1 additional day in cases other than Over Dimensional Cargo
Up to 20 km	1 day in case of Over Dimensional Cargo
For every 20 km or part thereof thereafter	1 additional day in case of Over Dimensional Cargo

Proviso amended to provide for exception circumstances including trans-shipment, the transporter may extend the validity after updating details in Part B and new e-way bill need not be generated.

Explanation 1 amended to provide that 1 day shall be period expiring at midnight of the day immediately following the date of generation of e-way bill (previously it was 24 hours counted from the time at which e-way bill is generated).

Explanation 2 added to provide meaning of **Over Dimensional Cargo** as single indivisible unit which exceeds the dimensional limit prescribed in Rule 93 of Central Motor Vehicles Rules, 1989 made under Motor Vehicles Act, 1988.

- Rule 138(11) amended to provide that the supplier, if registered (where information

in Part A is furnished by recipient or the transporter) or the recipient (where information in Part A is furnished by supplier or the transporter) shall communicate his acceptance or rejection of the consignment covered by the e-way bill.

- Rule 138(12) amended to provide that the consignment will be deemed to have been accepted if no response is filed within 72 hours of the details being made available on common portal or time of delivery of goods whichever is earlier.

- Scope of Rule 138(14) providing for exemptions from generation of e-way bills widened to include:

- ✓ goods, other than de-oiled cake, being transported, are specified in the Schedule to Notification No. 2/2017- CT (Rate) dt. 28-6-2017 as amended from time to time;
- ✓ alcoholic liquor for human consumption, petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas or aviation turbine fuel;
- ✓ goods not treated as supply under Schedule III of the Act;
- ✓ where the goods are being transported—
 - (i) under customs bond from an inland container depot / container freight station to a customs port, airport, air cargo complex and land customs station, or from one customs station or customs port to another customs station or customs port, or
 - (ii) under customs supervision or under customs seal;

- ✓ transit cargo from or to Nepal or Bhutan;
- ✓ goods exempt under Notification No. 7/2017-CT (Rate), dt. 28-6-2017 and 26/2017- CT (Rate), dt. 21-9-2017 as amended from time to time;
- ✓ any movement of goods caused by defence formation under Ministry of Defence as a consignor or consignee;
- ✓ where the consignor of goods is the Central Government, Government of any State or a local authority for transport of goods by rail;
- ✓ where empty cargo containers are being transported; and
- ✓ where the goods are being transported upto a distance of twenty kilometres from the place of the business of the consignor to a weighbridge for weightment or back there from subject to the condition that the movement of goods is accompanied by a delivery challan.
- ✓ Annexure amended to remove many goods from the exemption list.

Amended list is as under:

Sr. No.	Description of Goods
1	Liquefied petroleum gas for supply to household and non domestic exempted category (NDEC) customers
2	Kerosene oil sold under PDS
3	Postal baggage transported by Department of Posts
4	Natural or cultured pearls and precious or semi-precious stones; precious metals and metals clad with precious metal (Chapter 71)

5	Jewellery, goldsmiths' and silversmiths' wares and other articles (Chapter 71)
6	Currency
7	Used personal and household effects
8	Coral, unworked (0508) and worked coral (9601)

- Rule 138A amended to exclude transport of goods by rail, air and vessel from carrying copy of e-way bill in physical or electronic form or mapped to Radio Frequency Identification Device embedded onto the conveyance.
- Rule 138B amended to allow proper officer to verify e-way bill in electronic form.
- Rule 138C amended to restrict duplication of physical verification of goods being transported in any conveyance even within Union Territory in addition to within the State.
- In case of movement of goods on account of job-work, the registered job worker can also generate e-way bill.
- Once verified by any tax officer, the same conveyance will not be subject to a second check in any State or Union territory, unless and until, specific information for the same is received.
- Movement of goods on account of Bill-To-Ship-To supply will be handled through the capturing of place of dispatch in PART-A of e-way bill.

Clarification with respect to E-Way Bill System (Press Release dt. 31-3-2018)

- Where a consignor is required to move goods from City X to City Z. Transporter 'A' moves the goods from City X to City Y. Transporter 'A' hands over the goods to Transporter 'B' and thereafter, the goods are moved from City Y to City Z by Transporter B. In such a scenario,

only 1 e-way bill would be required. On reaching City Y, Transporter A will assign the said e-way bill to the Transporter B. Thereafter, Transporter B will be able to update the details of his vehicle in PART B of FORM GST EWB-01 and then move the goods from City Y to City Z.

- Where a Consignor hands over his goods for transportation on Friday to transporter. But, the assigned transporter starts the movement of goods on Monday. The validity period of e-way bill starts only after the details in PART B of FORM GST EWB-01 are updated by the transporter for the first time.

Rescinding notification No. 06/2018 – CT dated 23-1-2018 (Notification No. 13/2018 dt. 7-3-2018)
Notification for reduction of late filing fees of FORM GSTR 5A has been rescinded w.e.f. 7-3-2018. Accordingly, late filing fees of ₹ 200 per day shall be payable in case of delay in filing of return.

Amending the CGST Rules, 2017 (3rd Amendment Rules (2018) – (Notification No. 14/2018 dt. 23-3-2018)

Due date for filing of GSTR 3B and GSTR 1 for April to June'18 (Notification No. 16 dt. 23-3-2018 and 17, 18/2018 dt. 28-3-2018)

Month	Due date for GSTR 3B (Monthly filing)	Due date for GSTR 1	
		Agg. Turnover up to ₹ 1.5 cr. (Quarterly filing)	Agg. Turnover more than ₹ 1.5 cr. (Monthly filing)
April 2018	20-5-2018	31-7-2018	31-5-2018
May 2018	20-6-2018		10-6-2018
June 2018	20-7-2018		10-7-2018

Due date for filing of GSTR 6 for July'17 to April'18 extended up to 31-5-2018 (Notification No. 19/2018 dt. 28-3-2018)

Extension of due date for filing of refund by notified agencies (Notification No. 20/2018 dt. 28-3-2018)

Any specified agencies of the UNO or any Multilateral Financial Institution and Organization, Consulate or Embassy of foreign countries are eligible to claim refund u/s 55 of inward supplies of goods and services notified. The due date for claiming of such refund is extended to 18 months (previously 6 months) from the last day of the quarter in which such supplies are received.

Job work procedure

- Rule 45 amended to provide that in case where goods are sent by one job worker to another, the challan may be issued by the principal or the job worker sending the goods to another job worker. Also, the challan issued by the principal can be endorsed by the job worker specifying the details of goods sent out to another job worker and likewise can be done by another job worker for sending goods further on job work. Also, endorsement may be done while returning the goods to the principal.

Amendments in Anti-Profitteering Rules

- The composition of the Authority and procedure of investigation are amended through Rules 125, 129, 133, 134, 137.

Amendments in E-Way Bill Rules:

- Explanation to chapter added after Rule 138D - the expressions 'transported by railways', 'transportation of goods by railways', 'transport of goods by rail' and 'movement of goods by rail' does not include cases where leasing of parcel space by Railways takes place.

Central Goods & Services Tax Rate (CGST Rate)

Exemption from payment under RCM u/s 9(4) extended (Notification No. 10/2018 dt. 23-03-2018)

The provisions of S. 9 (4) of the Act relating to RCM in respect of supplies obtained by a registered person from an unregistered person, which were kept in abeyance till 31.03.2018, shall continue to remain in abeyance till 30.06.2018

Similar notification is issued under IGST (Rate) and UTGST (Rate)

CIRCULARS

Central Goods & Services Tax (CGST)

Clarification regarding GST on certain services (Circular No. 34/8/2018 dt. 1-3-2018)

- Activity of bus body building involves supply of both goods and services and hence classification of this composite supply to depend on which is the principal supply which may be determined on the basis of facts and circumstances of each case.
- Retreading of tyres is a composite supply with pre-dominant element of retreading which is supply of service. However, principal supply needs to be determined. Value is guiding factor but not the sole factor. Supply of retreaded tyres, where old tyres belong to supplier of retreaded tyres is a supply of goods and taxable under HSN 4012 @ 28%.
- Priority Sector Lending Certificates (PSLC's) are taxable as supply of goods at standard rate of 18% under the residuary S. No. 453 of Schedule III of Notification No. 1/2017.
- Activities carried by Distributor Companies (DISCOMS) such as application fees, rental charges for

metering equipment, testing fees, labour charges for shifting of meters or service lines, charges for duplicate bill etc are taxable under GST.

- Guarantee provided by State Government to state owned companies against guarantee commission is taxable.

Clarification regarding taxable services provided by JV and its members (Circular No. 35/9/2018 dt. 5-3-2018)

This circular is issued to clarify about taxable services provided by the members of the JV to the JV and vice versa and inter se between the members of the JV. Clarification issued is on the similar lines as was clarified under Service Tax vide CBEC Circular No. 179/5/2014 – ST dt. 24-9-2014 and accordingly if the cash call is merely a transaction in money, GST will not be applicable. This has been explained by way of following illustration:

Illustration A: 4 members in the JV including the operating member contributes ₹ 100 each (total ₹ 400) as part of their share. The operating member purchases machinery for ₹ 400 for the JV to be used in oil production.

Illustration B: 4 members in the JV including the operating member contributes ₹ 100 each (total ₹ 400) as part of their share. The operating member thereafter uses its own machine and performs exploration and production activities on behalf of the JV.

Illustration A will not be the subject matter of 'ST/GST' for the reason that money paid for purchase of machinery is merely in the nature of capital contribution and is thus a transaction in money. However, In illustration B, the operating member uses its own machinery and is therefore providing 'service' since, the operating member is recovering the cost appropriated towards machinery.

Clarification of issues relating to UIN entities (Circular No. 36/10/2018 dt. 13-3-2018)

- UIN entities have the option to apply for Centralized Registration. Return of inward supplies is to be filed in FORM GSTR 11 for period for which refund is claimed.
- FORM RFD-10 along with FORM GSTR-11 is to be submitted to the jurisdictional Central Tax Commissionerate. Nodal officer has been designated in this regard given as 'Annexure A' to this circular.

Clarification on exports related refund issues (Circular No. 37/11/2018 dt. 15-3-2018)

- Non-availment of drawback: No refund of ITC shall be allowed where the supplier avails drawback (excluding customs duty) in respect of GST. Further, refund of SGST shall be allowed even if supplier has availed drawback in respect of CGST.
- Amendment through Table 9 of GSTR 1: For processing of refund claims, amended information should be taken into cognizance. For any differences between GSTR 3B and GSTR 1, the officer is advised to refer to Circular No. 26/26/2017 dt. 29-12-2017 for rectification guidelines.
- Exports without LUT: The delay in furnishing of LUT in such cases may be condoned and the facility for export under LUT may be allowed on ex post facto basis taking into account the facts and circumstances of each case.
- Exports after specified period: The Jurisdictional Commissioner may consider granting extension of time limit on post facto basis if goods are not exported within 3 months from the date of invoice and the exporter should not be insisted upon to pay IGST as long as goods are actually exported.
- Deficiency Memo: Once deficiency memo is issued the applicant is required to file fresh refund application manually in FORM GSTR RFD-01A. Officer will not service another deficiency memo again unless previous deficiencies remain unrectified or any other substantive deficiency is noticed subsequently.
- Requirement for self-declaration of non-prosecution is already satisfied under LUT and asking for such declaration with every refund application is not warranted.
- Refund of transitional credit shall not be allowed as the definition of ITC under refund rules refers to "ITC availed on inputs and input services during the relevant period".
- In case of discrepancy between values of GST invoice and shipping bill / bill of export: lower of the value of goods declared in the invoice and the value of corresponding shipping bill / bill of export should be adopted for sanction of refund.
- Refund of taxes paid under existing laws shall be refunded in cash and no refund to be granted if the credit is already transitioned into GST.
- Filing frequency of refunds: The exporter may file refund application by clubbing more than 1 successive calendar month/quarter within same financial year and refund can be applied for ITC availed during a tax period even if there are no exports in that specific tax period.
- BIRC / FIRC is required only in case of export of services as per Rule 89(2). Thus, for processing of refund claims related to export of goods the same should not be insisted upon.
- Supplies to Merchant Exporters at concessional rate of 0.05% or 0.10% as the case may be, are optional. The exporter has to export under LUT and cannot export by paying IGST. Such supplier is eligible for refund on account of inverted tax structure.

- Requirement of invoices for processing of refund claims: Following documents are required for processing refund:

Type of refund	Documents
Export of Services with payment of tax (Refund of IGST paid on export of services)	<ul style="list-style-type: none"> ✓ Copy of FORM RFD-01A filed on common portal ✓ Copy of Statement 2 of FORM RFD-01A ✓ Invoices w.r.t. input, input services and capital goods ✓ BRC/FIRC for export of services ✓ Undertaking / Declaration in FORM RFD-01A
Export (goods or services) without payment of tax (Refund of accumulated ITC of IGST / CGST / SGST /UTGST / Cess)	<ul style="list-style-type: none"> ✓ Copy of FORM RFD-01A filed on common portal ✓ Copy of Statement 3A of FORM RFD-01A generated on common portal ✓ Copy of Statement 3 of FORM RFD-01A ✓ Invoices w.r.t. input and input services ✓ BRC/FIRC for export of services ✓ Undertaking / Declaration in FORM RFD-01A

Clarification on issues related to job work (Circular No. 38/12/2018 dt. 26-3-2018)

- Scope / ambit of job work: Whether the activity carried out by job worker is covered under job work is to be determined on the basis of facts and circumstances of each case. Further, can use his own goods for providing services of job work.
- Requirement of registration for the principal / job worker: Principal has to be registered but whether job worker should obtain registration or not depends on the turnover of job worker.
- Supply of goods by the principal from job worker's place of business / premises will be regarded as supply by the principal and not by the job worker
- Movement of goods from the principal to the job worker and the documents and intimation required:
 - ✓ The principal shall prepare challan in triplicate. 2 copies to be sent to job worker. The challan issued by the principal may be endorsed by the job worker for sending goods to another job worker. 1 copy of the challan to be sent back by the job worker when goods are returned. Where goods are returned in piecemeal by the job worker, fresh challan is required to be issued by the job worker.
 - ✓ The goods may move from the place of supplier (in case of imports, from the customs station) to place of job worker with a copy of invoice issued by supplier in the name of buyer (principal) and job worker's name and address as consignee. The buyer (principal) shall issue challan and send the same to the job worker directly.


- Supply of goods by the principal from job worker's place of business / premises or Supply of waste and scrap generated during the job work: The time, value and place of supply would have to be determined in the hands of the principal irrespective of location of job worker's place of business / premises. The invoice is to be issued by principal and LUT in case of export, is also to be executed by the principal.
- Where goods are not returned or supplied from job workers premises within stipulated time period, the principal would issue an invoice and date of supply shall be the date on which such inputs or capital goods were initially sent to the job worker and interest shall also be payable. If such goods are returned by the job worker after the stipulated time period, it would be treated as a supply by the job worker and the job worker would be liable to pay GST if he is liable for registration. However, there is no requirement of returning or supplying directly from job workers premises moulds and dies, jigs and fixtures, or tools.
- Availability of ITC to the principal and job worker: ITC would be available to the principal on goods / capital goods sent to job worker even if directly supplied by the supplier to job worker's premises. ITC is also available to job worker on inputs, etc. used by him in supplying the job work services if he is registered.

PRESS RELEASES

Decisions taken in 26th GST Council Meeting held on 10-3-2018 (Press release dt. 10-3-2018):

- Provisions for TDS and TCS to remain suspended upto 30-6-2018.
- GST implementation Committee (GIC) tasked with redressing the grievances caused to the taxpayers arising out of IT glitches.
- For Exporters, exemption on imported goods under export promotion scheme is extended and Implementation of e-wallet scheme is deferred for up to 1-10-2018.

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CA Naresh Sheth

INDIRECT TAXES

GST – Recent Judgments

1. **M/s. Proactive Plast Pvt. Ltd. vs. State of UP and others (2018-TIOL-15-HC-ALL-GST)**

Facts, issue involved and contention of petitioner

Petitioner's goods which were bought from outside the State of Uttar Pradesh were seized u/s. 129 of U.P. GST Act, 2017. Petitioner submitted that seized goods were in transit from outside the State. Rule 138 of the Rules framed under U.P. GST making E-way bill mandatory would apply only in respect of intra-State trade within the State of U.P. and not for goods brought from outside the State.

Held

Even if seizure is treated to be u/s. 129(1) of the CGST Act, as there was no provision of E-way bill on the relevant date under CGST Act and, therefore, *prima facie* seizure appears to be illegal. Counsel for revenue may seek instructions and file counter affidavit within two weeks and matter be listed for admission/final disposal thereafter.

Since goods seized are said to be perishable in nature, same are directed to be released along with vehicle subject to petitioner furnishing indemnity bond and security (other than cash

and bank guarantee) in respect of proposed tax and penalty on value of goods shown in documents accompanying same.

2. **M/s. Seth Prasad Agro Pvt. Ltd. vs. State of U.P. and Others (2018-TIOL-16-HC-ALL-GST)**

Facts, issue involved and contention of petitioner

Petitioner is engaged in business of manufacturing and sale of agricultural implement "Tasla" and was transporting the same from one State to another when the consignment was intercepted, detained and seized at Varanasi u/s. 129 of the U.P. GST Act, 2017.

Petitioner submitted that since transaction was an inter-state one, same is covered by the IGST Act, 2017 and is not liable to be seized under the U.P. GST Act. Petitioner further submits that consignment of goods has been seized by treating them to be 'Ghamella' rather than 'Tasla'. 'Tasla' was exempted from GST *vide* notification dated 29-6-2017 and 'Ghamella' has been included in the taxable goods *vide* notification dated 25-1-2018 and thus, on relevant date, 'Ghamella' was also an exempted item and order of seizure is patently illegal.

Held

Transaction in question is treated to be covered by IGST Act and provisions of U.P. GST Act would not apply. However, a similar provision as Section 129 of the U.P. GST Act exists in the Central GST Act as well. Section 20 of the IGST Act provides that provisions of Central GST Act would apply in respect of matters of inspection, search, seizure and arrest to matters covered by IGST Act. In other words, in matter of seizure under provisions of IGST Act, provisions of Central GST Act such as Section 129 would apply *mutatis mutandis*. The impugned order of seizure cannot be held to be bad in law. Impugned order is to be treated to have been passed under IGST Act read with Section 129 of the Central GST Act rather than one passed under U.P. GST Act.

Counsel for revenue is directed to seek instructions and file counter affidavit within a month. In the meantime, goods and vehicle seized are directed to be released on furnishing indemnity bond as well as security other than cash and bank guarantee of taxable amount of seized goods. Matter to be listed for admission / final disposal immediately after expiry of above period of one month and filing of rejoinder affidavit.

3. **K. K. Ramesh vs. Union of India (2018-TIOL-20-HC-MAD-GST)**

Facts, Issue involved and contention of petitioner

Petitioner seeks inclusion of petrol and diesel under GST on the ground that although International market price of crude oil per barrel is very low, an exorbitant increase in selling price of petroleum products directly affects common man for reason that most of goods are transported through road/service transport. Any increase in price of fuel is bound to increase selling price of commodities, especially essential commodities.

It is high time that petrol and diesel prices should be brought within ambit of Goods and

Services Tax (GST). Petitioner had submitted representation dated 16-6-2017 to respondents. In spite of receipt and acknowledgment, no response is forthcoming. Hence petitioner has approached High Court by filing writ petition.

Held:

GST Council is having representation of State Governments also and, therefore, their views have also to be elicited, before GST Council takes a call as to bring petrol and diesel within ambit of Goods and Services Tax. It is the prerogative of Central Government to take a call on basis of recommendations of GST Council. It is a well-settled position of law that “it is not for the Court to determine whether a particular policy or particular decision taken in the fulfilment of that policy is fair” and that Court can interfere only when it is found to be arbitrary or based on an irrelevant consideration or *mala fide* or against any statutory provisions. High Court is not in a position to issue any positive direction to the respondents to consider the prayer sought for by petitioner. Petition is dismissed.

4. **Willowood Chemicals Pvt. Ltd. vs. Union of India (2018-TIOL-21-HC-AHM-GST)**

Facts, issue involved and contention of Petitioner

Petitioner has challenged second proviso to Section 140(1) of Gujarat Goods and Services Tax Act under which certain restrictions have been imposed on a dealer for taking credit under new GST regime of taxes already paid under the VAT Act.

Counsel for petitioner submitted that the provision deprives a dealer to his vested right and thus, the statute acts retrospectively and also imposes an unreasonable restriction.

Held

Notice has been issued to Government to respond by 19-4-2018. Since *vires* of the State Act

are under challenge, notice has also been issued to the learned Advocate General.

5. M/s. Arihant Superstructure Ltd. vs. Union of India (2018-TIOL-22-HC-RAJ-GST)

Facts, issue involved and contention of petitioner

Petitioner is engaged in real estate business. The Department declined to accept GST TRAN-1 returns, amongst others, submitted by petitioner. Hence, writ petition is filed.

Held

Considering decision of Bombay High Court in *Abicor and Binzel Technoweld Pvt. Ltd. vs. The Union of India*, the Department is directed to accept GST TRAN-1 submitted by petitioner. This is to be done manually or by opening the portal. Notices issued to parties.

6. Padmavati Enterprise vs. Union of India and Another (2018-TIOL-17-HC-Mum-GST)

Facts, issue involved and contention of petitioner

Taxpayer preferred present petition complaining that e-returns filed by assessee were not generated on website of the department which resulted in taxpayer facing tremendous inconvenience.

Held

Court should not be flooded with litigations of this nature, as this will result in tax amount due

and payable being not recovered in time. This Court need not remind these authorities that even if returns are forwarded belatedly, they cannot be refused for those forwarding these returns after prescribed period. Therefore, there is no reason as to why returns are not being accepted or not loaded on the site. Further, this Court directs both the Commissioners to remain present in this Court on the next date with the original records.

7. Maa Vindhyavasini Tobacco (P.) Ltd. vs. State of U.P. [(2018) 91 taxmann.com 214 (Allahabad)]

Held

Goods had been seized on two grounds, one being discrepancy in the quantity. That discrepancy has been resolved and it is accepted to department that quantity of goods as disclosed in documents is same as found on physical verification.

Other ground of seizure on which penalty has been imposed is that goods, started their journey one week after date of invoice. *Prima facie* that cannot be the ground to seize goods or to impose penalty.

Learned standing counsel prays for and is granted three weeks' time to file counter affidavit. Petitioner will have one week thereafter to file rejoinder affidavit.

In meanwhile, subject to petitioner furnishing security equal to value of goods and tax payable, in form of indemnity bond, vehicle along with goods shall be released in favour of the petitioner forthwith.

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Along with the development of concentration we must develop the power of detachment.

— Swami Vivekananda



CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES

Service Tax – Case Law Update

Citation: 2018-TIOL-76-SC-ST

Case: UOI & Anr. vs. Intercontinental Consultants and Technocrats Pvt. Ltd.

Background facts of the case

The assessee M/s. Intercontinental Consultants and Technocrats Pvt. Ltd., is a provider of consulting engineering services. In the course of the carrying on of its business, the petitioner rendered consultancy services in respect of highway projects to the National Highway Authority of India (NHAI). The petitioner receives payments not only for its service but is also reimbursed expenses incurred by it such as air travel, hotel stay, etc. It was paying Service tax in respect of amounts received by it for services rendered to its clients. It was not paying any Service tax in respect of the expenses incurred by it, which was reimbursed by the clients. Therefore, on the basis of Service tax audit observations, a show cause notice dated March 17, 2008 for the period October, 2002 to March, 2007 was issued by the Commissioner, Service tax, Commissionerate *vide* which the respondent was asked to show cause as to why the Service tax should not be recovered including the amounts of reimbursables which were received by the respondent, pointing out these were to be included while arriving at the gross value as per provisions of Rule 5(1) Service Tax (Determination of Value) Rules,

2006. Against the said SCN, assessee filed writ petition before Delhi High Court, challenging Rule 5(1) of Valuation Rules, 2006 to be *ultra vires* the provisions of Section 67 of the Act.

The Hon'ble Delhi High Court observed that:

- The provisions both amended and un-amended Section 67 authorised the determination of value of taxable services for the purpose of charging service tax under Section 66 (which is a charging section) as the gross amount charged by the service provider for such services provided or to be provided by him, in a case where the consideration for the service is money.
- Emphasising on the words 'for such service', the High Court took the view that the charge of Service tax under Section 66 has to be on the value of taxable service i.e., the value of service rendered by the assessee that can be brought to charge and nothing more. The quantification of the value of the service can, therefore, never exceed the gross amount charged by the service provider for the service provided by him.
- The expenditure or cost incurred by the service provider in the course of providing the taxable service can never be considered

as the gross amount charged by the service provider 'for such service' provided by him. Accordingly, Rule 5 of Valuation Rules, 2006 goes beyond the Section which was impermissible as the Rules which have been made under Section 94 of the Act can only be made 'for carrying out the provisions of this Chapter' (Chapter V of the Act) which provides for levy, quantification and collection of the Service tax.

- It may even result in double taxation inasmuch as expenses on air travel tickets are already subject to Service tax and are included in the bill. No doubt, double taxation was permissible in law but it could only be done if it was categorically provided for and intended and could not be enforced by implication.

Arguments put forth

The appellants (revenue) submitted as under:

- a) Section 67 specifically lays down the principle of gross amount charged by a service provider for the services provided or to be provided, Rule 5 did not go contrary to Section 67 as it only mentions what would be the meaning of gross amount charged. While dealing with the valuation of a taxable service, the provision which deals with valuation has to be taken into consideration and no assistance can be taken from charging section, as held in *Union of India & Ors. vs. Bombay Tyre International Limited & Ors.*
- b) Delhi High Court had committed serious error in relying upon Section 66 of the Act (which is a charging section) while interpreting Section 67 of the Act, or for that matter, while examining the validity of Rule 5 of the Rules.
- c) Section 67 which uses the term 'any amount' would include quantum as well as the nature of the amount and, therefore,

cost for providing services was rightly included in Rule 5, which was not *ultra vires* Section 67 of the Act.

The respondents (assessee) submitted as under:

- a) Judgment of the High Court was perfectly in tune with legal position and did not call for any interference
- b) Section 67 was again amended by the Finance Act, 2015 w.e.f. May 14, 2015. For the first time, w.e.f. May 14, 2015, reimbursement of expenditure or cost incurred by the service provider gets included under the expression 'consideration', which legal regime did not prevail prior to May 14, 2015. Therefore, for the period in question, the 'consideration' was having limited sphere, viz. It was only in respect of taxable services provided or to be provided.
- c) Para 2.4 of Circular/Instructions F. No. B-43/5/97-TRU dated June 6, 1997 clarified that 'various other reimbursable expenses incurred are not to be included for computing the Service tax.'

Observations of the SC

- a) Prior to April 19, 2006, i.e., in the absence of Rule 5(1), the valuation was to be done as per the provisions of Section 67 of the Act. On interpreting Section 66 of the Act, it can be inferred that it is the value of the services which are actually rendered, the value whereof is to be ascertained for the purpose of calculating the service tax payable thereupon.
- b) In this hue, the expression 'such' occurring in Section 67 of the Act assumes importance. In other words, valuation of taxable services for charging service tax, the authorities are to find what is the gross amount charged for providing 'such' taxable services. As a *fortiori*, any other amount which is calculated not for

providing such taxable service cannot be a part of that valuation as that amount is not calculated for providing such 'taxable service'. That is the plain meaning which is to be attached to Section 67 unamended, (i.e., prior to May 1, 2006) or after its amendment. Once this interpretation is to be given to Section 67, it hardly needs to be emphasised that Rule 5 of the Rules went much beyond the mandate of Section 67.

- c) Sub-section (4) of Section 67 empowers the rule making authority to lay down the manner in which value of taxable service is to be determined. However, Section 67(4) is expressly made subject to the provisions of sub-section (1). Mandate of sub-section (1) of Section 67 is manifest, viz., the Service tax is to be paid only on the services actually provided by the service provider. It is trite that rules cannot go beyond the statute.
- d) As held in case of Taj Mahal Hotel, "the Rules were meant only for the purpose of carrying out the provisions of the Act and they could not take away what was conferred by the Act or whittle down its effect."
- e) The aforesaid view gets strengthened from the manner in which the Legislature itself acted. Realising that Section 67, dealing with valuation of taxable services, does not include reimbursable expenses for providing such service, the Legislature amended by Finance Act, 2015 with effect from May 14, 2015, whereby Clause (a) which deals with 'consideration' is suitably amended to include reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service. This is a substantive change brought about with the amendment to Section 67 and, therefore, has to be prospective in nature. Reference shall be

made to Constitution Bench judgment in the case of *Commissioner of Income Tax (Central)-I, New Delhi vs. Vatika Township Private Limited* (2015) 1 SCC 1 = 2014-TIOL-78-SC-IT-CB.

Citation: 2018-TIOL-310-HC-DEL-ST

Case: *Cellular Operators Association of India and Ors. vs. UOI*

Background facts of the case

The writ petition was filed by appellants for quashing of Notification No. 22/2015-CE(NT) dated 29th October, 2015 as violating Articles 14, 19(1)(g), 265 and 300A of the Constitution of India, and for direction that the credit accumulated on account of Education Cess (EC, for short) and Secondary and Higher Education Cess (SHE, for short) should be allowed to be utilised for payment of Service tax leviable and payable on telecommunication services.

As per the CCR, 2004 cross utilization of EC and SHE towards excise duty or service tax was impermissible and not permitted. EC and SHE were abolished and were not payable on excisable goods with effect from 1st March, 2015 *vide* Notification Nos. 14/2015-CE and 15/2015-CE both dated 1st March, 2015. EC and SHE were also abolished and ceased to be payable on taxable services w.e.f. 1st June, 2015.

The grievance of the petitioners is, and they claim a vested right to avail benefit of the unutilised amount of EC or SHE credit, which was available and had not been set off as on 1st March, 2015 and 1st June, 2015 for payment of tax on excisable goods and taxable services respectively. The contention is that EC and SHE were subsumed in the Central Excise Duty, the general rate of which was increased from 12% to 12.5%, and Service tax, which was increased from 12.36% to 14%. Therefore petitioners contended unutilised EC and SHE should be allowed to be utilised for payment of basic excise duty in excisable goods and Service tax on taxable service.

Arguments put forth

The appellants submitted as under:

- a) That EC and SHE had been subsumed and included in the excise duty and Service tax, and therefore, the amount lying in the credit towards EC and SHE should be available for availing CENVAT credit. This was not a case of abolition of EC and SHE, but the cesses were added and became part of the excise duty or Service tax. The term "subsumed", which means to include, absorb in something else or incorporated into something larger or more general.
- b) Reliance is placed upon the Budget Speech of the Finance Minister and the memorandum explaining provisions of Finance Bill, 2015 & Explanation given by the Joint Secretary, Tax Research Unit, Ministry of Finance, Government of India, *vide* letter F.No.334/5/2015-TRU dated 28th February, 2015.
- c) Therefore under law, unutilised EC and SHE should be allowed to be utilised for payment of basic excise duty in excisable goods and Service tax on taxable service, otherwise tantamount to lapsing of credit accrued on the input, though higher excise duty or Service tax was payable on the output. The petitioners, it is asserted, have a vested right to claim benefit of utilisation of the unutilised credit.
- d) References were also made to the amendments brought out under CCR, 2004 which partially permit utilisation of EC and SHE by adding six provisos in Rule 3(7)(b) *vide* Notification 12/2015-CE(NT) dated 30th April, 2015 & Notification 22/2015 CE(NT) dated 29th October, 2015.
- e) Accordingly, some cases have permitted credit of EC and SHE and utilization of accumulated credit for payment of excise duty and service tax.

The Respondents submitted as under:

- a) The effect of the legislation withdrawing EC and SHE was to abolish the cess, though while presenting the Bill, etc. and giving reasons for increase in the excise duty and service tax, it was stated that EC and SHE would not be henceforth levied and would get subsumed in the higher rate of tax. Cross-utilization of EC and SHE credit was never permitted and allowed under the earlier provisions.
- b) The two notifications incorporating provisos to rule 3(7)(b) of CCR, 2004 have a very limited application as they apply to cases of excise duty where capital goods or inputs or input services on which EC and SHE had been paid, have been received by the manufacturer or service provider after the abolishment of EC& SHE w.e.f. 1st March, 2015 & 1st June,2015 respectively.
- c) These, as elucidated and explained, were new benefits and concessions granted, as cross utilization was earlier not permitted and allowed. Any new concession or benefit given, would not in law on stand-alone basis, confer a legal right to claim vested right to a concession or benefit which has not been granted.

Decision

- a) The provisos added to Rule 3, sub-rule (7) in clause (b) are really in the nature of concessions confined to a limited and narrow set of cases and are not of general application. They expand the scope and give benefit of utilisation of accumulated EC and SHE against payment of excise duty and Service tax, which was not the position prior to 1st March, 2015 and 1st June, 2015, respectively. These cases certainly fall in a distinct and separate class. The said classification would not fall foul of vice of discrimination. Article 14 of Constitution of India is not offended.

- b) The use of the words "subsumed" in the Budget Speech with reference to the two cesses could well indicate that there would not be an increased tax burden being put on the payers or the consumers, as EC and SHE were being withdrawn. Noticeably, the two cesses and the excise duty and the service tax were always treated as different and separate and cross-utilisation was never permitted. It is no doubt true that the two cesses, in the present case, were in the nature of taxes and not fee, but it would be incorrect and improper to treat the two cesses as excise duty or Service tax. They were specific cesses for the objective and purpose specified. No promise and statement that cross utilisation of EC and SHE would be permitted was made. The petitioners seek an addition and expansion to what was stated and intended.
- c) Reliance is placed on the decision of in *Shashikant Laxman Kale and Another versus Union of India and Another*, (1990) 4 SCC 366 = 2002- TIOL-2506-SC-IT-LB, wherein the Supreme Court held that the petitioner therein could not draw support from the heading in the explanatory note and explanatory memorandum would usually not be an accurate guide of the final enactment.
- d) In the National Asylum Support Service case ([2002] 1 WLR 2956), it has been observed that explanatory notes accompany a Bill on introduction and are updated in the light of changes to the Bill made in the Parliamentary process. They are prepared by the Government department responsible for the legislation. They do not form part of the Bill, are not endorsed by Parliament and cannot be amended by Parliament. They are intended to be neutral in political tone; they aim to explain the effect of the text and not to justify it.
- e) Credit of EC and SHE could be only allowed against EC and SHE and could not be cross-utilised against the excise duty or Service tax. In fact, what the petitioners seek is an amendment of the scheme to allow them to take cross utilisation of the unutilised EC and SHE upon the two cesses being withdrawn against excise duty and Service tax, though this was not the position even earlier. Both EC and SHE were withdrawn and abolished. They ceased to be payable. In these circumstances, it is not possible to accept the contention that a vested right or claim existed.
- f) Accordingly, writ petition was dismissed.

Citation: 2018-TIOL-288-HC-MUM-ST

Case: *Commissioner of Service Tax vs. Shree Krishna Chaitanya Enterprises, Green Valley Developers, Kumar Beheray Rathi*

Background facts of the case

The assessee is engaged in the business of construction of buildings and is a builder and developer. They collect amounts as a builder/ developer towards the maintenance of common facilities and the Tribunal had struck down the levy of service tax on such amounts collected from the prospective flat buyers. The revenue filed appeal in relation to the finding of the Tribunal and its ultimate conclusion that the assessee was not providing management, maintenance or repair services by collecting the amount from prospective flat buyers, for maintaining the building in the guise of deposit which is not refundable.

Arguments put forth

The revenue as appellants submitted as under:

- a) The CESTAT has presumed that in taking deposits the assessee acts as a Trustee or pure agent. The agreements made between the assessee and the buyers of the flats submitted by the assessee on a sample

basis also confirms the factual position that the assessee received the amounts from the buyers for maintenance and repairs of the property. Thus it was providing a taxable service.

- b) The Tribunal has rendered conflicting Orders and Judgments and in that regard the attention was invited to an order passed by the Tribunal's South Zonal Bench, Chennai and the orders passed by the Tribunal in the case of some builders holding that maintenance charges collected by them are their income. However, the Tribunal relied upon another order passed in the case of *Kumar Behary Rathi vs. Commissioner of Central Excise, Pune-III* {2014 (34) S.T.R. 139 (Mumbai)} and that, does not take into consideration the various facets of the services rendered. Therefore it was submitted that the Tribunal's findings are erroneous and its conclusions thus unsustainable in law

The Assessee Respondent submitted as under:

- a) The Assessee submitted that we should not lose focus and sight of the Maharashtra Ownership Flats (Regulation of the Promotion of Construction, Sale, Management and Transfer) Act, 1963 ("MOFA" for short). The assessee is a promoter within the meaning of this law. The Tribunal, on appreciation and appraisal of all the factual materials and in the backdrop of the obligations and duties, particularly mentioned in Sections 5 and 6 of the MOFA, correctly concluded that Service tax is not leviable on such amounts which are collected as maintenance charges for the up-keep of the apartment or premises.

Decision

- a) Since the MOFA has been referred by the counsel appearing before us, we would be required to make a reference to its provisions. The MOFA is an Act

to regulate in the State of Maharashtra, the promotion of the construction of the sale and management, and the transfer of Flats on ownership basis. It was brought to the notice of the State Government that, consequent on the acute shortage of housing in several areas of the State of Maharashtra, sundry abuses, malpractices and difficulties relating to the promotion of construction, and the sale and management and transfer of Flats taken on ownership basis exist and are increasing. That is why the Government decided to appoint a Committee to advise it and that Committee inquired into and reported to the State Government on several matters referred to aforesaid with the purpose of considering measures for their amelioration. Then, the report of the Committee was published for general information and after considering its recommendations and suggestions, it was decided to make provision during the period of such shortage of housing, for the regulation of the promotion of the construction, sale and management and transfer of flats taken on ownership basis in the State of Maharashtra.

- b) Section 3 of the MOFA provides for general liabilities. The sub-section (1) of this provision opens with a *non-obstante* clause and states that, notwithstanding anything in any other law, a promoter who intends to construct or constructs a block or building of flats, all or some of which are to be taken on ownership basis, shall in all transactions with persons intending to take or taking one or more of such flats, be liable to give or produce, or cause to be given or produced, the information and the documents mentioned in this section. Then, by sub-section (2) the liabilities are set out. The promoter before accepting advance payment or deposit has to enter into agreement and the agreement to be registered. That is an aspect taken

care of by Section 4 and by Section 4A, the effect of non-registration of agreement required to be registered under Section 4 is set out.

- c) By Section 5, it is stated that the promoter shall maintain a separate account in any bank of the sums taken by him, from persons intending to take or who have taken flats, as advance or deposit, including any sums so taken towards the share capital for the Formation of a co-operative society, or towards the outgoings, including ground rent if any, municipal or other local taxes, taxes on income, water charges, electricity charges, revenue assessment, interest on any mortgage or other encumbrances if any, and he shall hold the said moneys for the purposes for which they were given and shall disburse the moneys for those purposes and shall on demand in writing by a Competent Authority, make full and true disclosure of all transactions in respect of that account. By Section 6, it is clear that there is a responsibility for payment of outgoings till property is transferred. A promoter shall while he is in possession, and where he collects from persons who have taken or are to take over flats, sums for the payment of outgoings even thereafter, pay all outgoings until he transfers the property to the persons taking over the flats, or to the organisation of any such persons and the promoter shall continue to be liable in terms of this provision. Then, by Section 7 there are certain other matters and which are taken care of, namely, plans and specifications disclosed cannot be altered. The refund of amount paid with interest for failure to give possession within specified time or further time allowed, is a matter covered by Section 8. Then, by Section 9 no encumbrance can be created without consent of parties after execution of Agreement for Sale.
- d) Then by Section 10, the promoter has to take steps for formation of co-operative society or company, and by Section 11 the promoter to convey title, etc., and execute documents according to the agreement.
- The arguments of the revenue fail to take note of this backdrop and in which it terms the obligations and duties under the MOFA to be rendering of taxable service. The law enacts a regulatory mechanism so that there is enough safeguard and protection for such flat takers and unit purchasers which would ensure to them a title in the property. The title in the building has to be conveyed together with the rights to the land beneath it. The land beneath and appurtenant to the building therefore enables the building owner, namely, a co-operative housing society or a company to enjoy the fruits of the development. There are often complaints and cases of unscrupulous builders and developers fleecing and cheating flat purchasers. Therefore, a complete mechanism till conveying of the property is put in place. Prior thereto, it is the promoter form the legal entity, namely, a co-operative housing society or a company. It is towards that end that he has to hold on to the property and the money for complete discharge of his eventual duty and function. Until that stage is reached, he has to maintain, safeguard and protect the property. Therefore, when he maintains the structure or repairs it, he is not rendering a taxable service in the sense envisaged by the Financial Act, 1994. If one loses complete focus or sight of the backdrop in which the so called service is rendered, then, the conclusion as erroneous and suggested by the revenue will be reached.
- e) Accordingly, revenue's appeal was dismissed.

Citation: 2018-TIOL-424-HC-AHM-ST

Case: Coastal Container Transporters Association vs. Union of India

Background Facts of the case

In the present case, the petitioner is a body whose members are, *inter alia*, goods transport operators and engaged in the business of transportation of goods supplied by the customers. It is the case of the petitioners that the show cause notices issued to some members and that the other members of the Association are likely to receive such show cause notices in due course and accordingly filed a writ petition. It is the case of the petitioners that the members of the Association undertake the following activities for providing services to various customers:

- (i) When the order is received from customers, it was a clear understanding between members of petitioner and its customers that the petitioners would merely provide service of transportation of goods by road whereas services at port area and transportation of goods through waterways would be provided by Shipping Lines;
- (ii) The petitioners would raise a bill for transportation of goods by road and debit note for recovery of the expenses that would be incurred by shipping lines for providing services at port area and transportation of goods through waterways;
- (iii) It is clear understanding between the petitioners and customers that the petitioners would not add any margin while recovering money from its customers towards port and shipping line charges;
- (iv) Upon receipt of an order from customers to transport goods from their place to persons who are mostly located in South India, the petitioners hire a truck along

with empty container for this purpose and send the same vehicle to the place/factory of customers;

- (v) Consignor undertakes responsibility of loading of goods;
- (vi) The petitioners approach shipping lines who undertake responsibility for loading containerised goods at Kandla/Mundra port in Gujarat;
- (vii) Shipping lines look after the containerized goods at Kandla/Mundra in Gujarat;
- (viii) Shipping lines load containerised goods in coastal vessel at Kandla/Mundra Port in Gujarat;
- (ix) Customers/consignors give a declaration/undertaking to the Customs for coastal movement of goods and recognise the shipping lines as their authorised agents permitted to transport the containers on their behalf. Further, even under Bill of Coastal Goods issued by the shipping lines for coastal transportation, the details of the consignor and consignee are clearly indicated. Consignor authorises shipping lines or its agent to sign/present/process the Bill of Coastal Goods at the Customs House on behalf of them;
- (x) Shipping lines transport containerised goods from Kandla/Mundra ports to containerised port in South India;
- (xi) Shipping lines offloads containerized goods at discharge port in South India;
- (xii) Shipping lines look after containerised goods at discharge port in South India;
- (xiii) Shipping Lines or Customers undertake responsibility of loading of containerised goods on lorry at discharge port in South India;
- (xiv) Consignee unloads the containerised goods at the place of consignee.

It is the case of the petitioners that they provide services of transportation of goods by road; the activities of loading and unloading of goods at loading point and discharge point are undertaken by the consignor or the consignee and that the petitioners provide trucks along with its container at the factory of the customers. It was the case of the revenue to classify the services under Cargo Handling Services.

Arguments put forth

The petitioner submitted as under:

- a) It was submitted that the main activity of the petitioners is of "goods transport agency". Reference was made to the definition of "goods transport agency" as prevailing prior to the year 2012, as defined under Section 65(50)(b) of the Finance Act, which provides that "goods transport agency" means any person who provides service in relation to transport of goods by road and issues consignment note, by whatever name called. It was submitted that the definition contemplates satisfaction of three ingredients, viz., the agency must be any person; it must provide service in relation to transport of goods by road and the agency must issue consignment note, by whatever name called.
- b) The attention of the Court was drawn to Circular No.B11/1/2002-TRU dated 1st August, 2002 issued by the Central Board of Excise and Customs, to point out that in relation to "cargo handling services", the Board has explained that mere transportation of goods is not covered in the category of cargo handling and is, therefore, not liable to Service tax. It was submitted that insofar as the petitioner association is concerned, its members do not carry out any activity of packing or unpacking and if at all any activity of loading or unloading is undertaken, the same is merely incidental to the main activity of goods transport agency. It was pointed out that in the said circular, it has also been clarified that if the bill indicates the amount charged for cargo handling and transportation separately on actuals basis (verifiable by documentary evidence), then the tax would be leviable only on the cargo handling charges.
- c) Reference was made to a clarificatory circular being Circular No.104/7/2008-S.T. dated 6-8-2008 issued by the Central Board of Excise and Customs, wherein the Board has clarified that "goods transport agency" provides service to a person in relation to transportation of goods by road which is a single composite service. Goods transport agency also issues consignment note. The composite service may include various intermediate and ancillary services provided in relation to the principal service of the road transport of goods. Such intermediate and ancillary services may include services like loading/unloading, packing/unpacking, transshipment, temporary warehousing etc., which are provided in the course of transportation by road.
- d) It was submitted that even after the introduction of the negative list, *vide* Circular No.186/5/2015-S.T. dated 5-10-2015, the Board has clarified that the single composite service need not be broken into its components and considered as constituting separate services, if it is provided as such in the ordinary course of business; thus, a composite service, even if it consists of more than one service, should be treated as a single service based on the main or principal service. It was submitted that the present case, therefore, falls within the exception of being contrary to the circulars issued by the C.B.E.C. and hence, the petitioners are entitled to avail of the remedy under Article 226 of the Constitution against the show cause notices.

The Department Representatives submitted as under:

- a) It was submitted that with effect from 1st July, 2012, the scheme of the service tax has changed and the negative list of regime has been brought into force. It was submitted that therefore, the circulars issued prior to the amendment in the Finance Act, would not be applicable subsequent to such amendment.
- b) Reference was made to Section 66F of the Finance Act which provides the principles of interpretation of specified descriptions of services or bundled services and more particularly, to sub-section (3) thereof which provides for the manner of determination of the taxability of a bundled service. Clause (b) thereof provides that if various elements of such service are not naturally bundled in the ordinary course of business, it shall be treated as provision of the single service which results in highest liability of Service tax. It was submitted that the petitioners have bundled together the service of "goods transport agency" as well as "cargo handling service" and the elements of such service are not naturally bundled in the ordinary course of service and, hence, the same is required to be treated as provision of the single service which results in highest liability of Service tax. It was submitted that out of the services which are being bundled together by the petitioners, the Service tax liability of "cargo handling service" results in highest liability and therefore, the services of the petitioners are required to be classified under the said head.
- c) Reference was made to the definition of "cargo handling service" as it stood prior to its substitution by the Finance Act, 2008 on 10-5-2008, to submit that the earlier definition provided that "cargo handling service" means loading,

unloading, packing or unpacking of cargo and includes cargo handling services in special containers or for non-containerised freight, services provided by a container freight terminal or any other freight terminal, for all modes of transport. It was submitted that thus, under the said definition, cargo handling service did not include transportation. It was submitted that with effect from 16-5-2008, the definition of cargo handling service came to be amended by including the service of packing together with transportation of cargo or goods, with or without one or more other services like loading, unloading, packing, unpacking. Thus, transportation was included as an ingredient of cargo handling services.

Decision

- a) From the nature of the services rendered by the petitioners as emerging from the record, in essence and substance, the contract is a contract for transport of goods from the place of the consignor to the place of the consignee or to the port in South India from where the consignee picks up the goods. The petitioners do not carry on any activity of packing and unpacking of goods. In so far as loading and unloading of goods is concerned, the consignor loads the goods into the container and the consignee unloads the same. It is only when the container reaches the port that it has to be unloaded and loaded on the ship, which is done by the shipping company or a cargo handling agency, which renders such services to the petitioners who act on behalf of the customers.
- b) The expression "cargo handling service" was defined prior to 2012. As per the definition of "cargo handling service" as it stood prior to 16-5-2008, "cargo handling service" essentially meant loading, unloading, packing or unpacking of cargo

for all modes of transport and cargo handling service incidental to freight. After 16-5-2008, the definition of "cargo handling service" came to be expanded by including "service of packing together with transportation of cargo or goods, with or without one or more of other services like loading, unloading, unpacking. Thus, prior to 16-5-2008, cargo handling service meant only loading, unloading, packing or unpacking of cargo for all modes of transport and cargo handling service incidental to freight whereas with effect from 16-5-2008, for the first time transportation came to be brought within the ambit of cargo handling service, which however was limited to the service of packing together with transportation of cargo or goods, with or without one or more of other services like loading, unloading, unpacking. Thus, in so far as transportation is concerned, the same was included within the definition of cargo handling service only in conjunction with packing. The other services like loading, unloading and unpacking were only ancillary to the main function of packing together with transportation. Thus, if transportation is to be included in cargo handling service, packing is an essential ingredient of the same. In other words if there is transportation of goods/cargo without the essential element of packing it would not fall within the ambit of cargo handling service.

c) Thus, even if the petitioners had not split up the transaction into three parts, viz. transportation by road, then unloading and loading at port and transportation by sea, followed by unloading and loading at the port and transportation by road, the transaction would not fall within the ambit of "cargo handling service" as defined under the Finance Act, 1994 as it stood prior to and after 16-5-2008 inasmuch as the petitioners do not provide the service

of packing together with transportation. Insofar as the period after the negative list regime came into force is concerned, the definition of "cargo handling service" stands deleted and is no longer on the statute book.

- d) In the facts of the present case, apart from the fact that the main activity of the petitioners is transportation by road and no cargo handling service activities are carried out by them, even if for the sake of assumption the services rendered by the shipping lines were to be considered as the services rendered by the petitioners, the essential character of the services rendered by the petitioners, viz., goods transport agency, would not be lost.
- e) A perusal of the impugned show cause notices show that the same propose to levy service tax on the petitioners in the category of "cargo handling service", which is clearly contrary to the above referred circulars issued by the C.B.E.C. from time-to-time and are also contrary to the very basic definition of "cargo handling service" as it stood prior to 2012. The impugned show cause notices relate to the period prior to 2012 as well as post 2012, both of which periods are covered by the circulars issued by the C.B.E.C. in the context of "goods transport agency service". In the light of the above discussion, it is evident that the impugned show cause notices are contrary to the binding circulars issued by the Central Board of Excise and Customs from time-to-time. Accordingly the writ petition was allowed.

Citation: 2018-TIOL-857-CESTAT-MUM

Case: *Commissioner of Central Excise, Kolhapur vs. Kamud Drugs Private Limited*

Background facts of the case

The assessee is a manufacturer of Bulk Drugs falling under Chapter 29 of the Central Excise

Tariff Act, 1985. During the scrutiny of the appellants' documents the Central Excise officers observed that the appellants had supplied the Drug Master File (DMF)/Technical Package (TECHPACK) to various customers and recovered on data/information about the goods such as size, bulk density, crystalline form, customers to study the manufacturing and testing procedures in respect of the goods of the appellants. It was alleged that the said activity was to be considered scientific or technical consultancy service.

Arguments put forth

The revenue as appellants submitted as under:

- a) It was submitted that the assessee has rendered the services of technical assistance relating to manufacture/testing of drugs to their customers who have paid money to obtain these DMF/TECHPACK. He further submits that the customers of the assessee have invested huge sums in purchase of the DMF/TECHPACK which is nothing but information/data relating to the manufacture of bulk drugs or pharmaceutical or any other products provided as per the customer's specification. He also submits that DMF/TECHPACK is nothing but technical assistance in the field of pharmaceutical products.

The assessee respondent submitted as under:

- a) The assessee had filed an appeal before the Commissioner (Appeals) on various grounds including the ground that the appellants are manufacturers of excisable goods and not any scientist or technocrat or any science of technology institutes and hence they cannot be treated as provider of scientific or technical consultancy service. Commissioner (Appeals) after considering the submission of the assessee

allowed the appeal of the assessee. However, when appeal was filed by the revenue, nobody appeared on behalf of the assessee.

Decision

- a) The assessee is a manufacturer of excisable goods and they are not scientist or technocrat or any science or technology institute. Therefore, the service rendered by them cannot be treated as provider of scientific or technical consultancy. Further, we find revenue has misinterpreted the statutory definition as provided under Section 65(92) of the Act.
- b) "Scientific or Technical Consultancy" means any advice, consultancy or scientific or technical assistance, rendered in any manner, either directly or indirectly, by a scientist or a technocrat, or any science or technology institution or organisation to a client, in one or more disciplines of science or technology.
- c) Further, it was noted that the Commissioner (Appeals) while allowing the assessee's appeal has relied upon the decisions of the Tribunals in the case of *Steel Cast Ltd. vs. Commissioner of Central Excise Bhavnagar – 2009(14)STR 129(Tri Ahmd.)* and *Administrative Staff College of India vs. CCE& CE, Hyderabad – 2009(14)STR 341(Tri. Bang.)*.
- d) The Order of the Commissioner (Appeals) was passed after considering various decisions of the Tribunal cited *supra* and also has considered the definition 'Scientific or Technical Consultancy' service as defined under section 65(92) of the Finance Act, 1994 and accordingly the same has been upheld by dismissing the appeal of the revenue.

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Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

Case Law # 1

[2018] 207 Comp Cas 47 (NCLAT)

[*Before the National Company Law Appellate Tribunal ("NCLAT")- New Delhi.*]

Achintya Kumar Barua alias Manju Baruah and Others vs. Ranjit Barthkur and Another

The Secretarial Standard guidelines which states that video conferencing participation can be done "if the company provides such facility", cannot override the provisions under the Rules and mandate under section 173(2) read with rules mentioned cannot be avoided by the companies.

Brief facts

The appeal has been filed against the order of the National Company Law Tribunal ("NCLT"), Guwahati Bench. The respondent has moved the petition before the NCLT seeking facility of attending the board meeting through video conferencing. NCLT, upon hearing, has made an order directing the company to make available the facility under section 173(2) of the Companies Act, 2013 ("Act").

The appellant who are other directors of the company has filed an appeal against the above order on behalf of the company.

The appellant have made the following submission.

1. They have an apprehension that with the original petitioner participating through video conferencing, it may not be possible to ensure that some other person is not present.
2. The Secretarial Standard has provided that such option under the provisions of the new Act and the Rules should be restored to only when the facilities are provided by the company to its directors.
3. Section 173(2) of the Act is not a mandatory provisions and hence it is not compulsory for the company to provide such facilities.
4. The Rule 3 of the Companies (Meetings of Board and Its Powers) Rules, 2014 has made the Chairperson responsible to ensure that no person other than the concerned director is attending.

5. If, director resorts to availing facility of video conferencing, then it would not be possible for the chairperson to ensure that the director alone is participating.

Judgment

The NCLAT has denied the appeal. It has noted that there is no reason to interfere in NCLT order and same is progressive and in the right direction. It has analysed the provisions of section 173(2) of the Act, which allows the directors to participate through video conferencing and other audio visual means as may be prescribed... From appellants side, it is argued that the use of the word "may" makes it clear that the provision is directory and not mandatory. NCLAT has concluded that this section provides options to director to choose whether he would be participating in person or through video conferencing. The word "may" does not give option to the company to deny this right given to the directors. On further analysis of Rule, it is clear that it requires the company to comply with the procedure prescribed for convening and conducting the board meetings through video conferencing. The Secretarial Standard guidelines which states that such participation can be done "if the company provides such facility", cannot override the provisions under the Rules and mandate under section 173(2) read with rules mentioned cannot be avoided by the companies.

Case Law # 2

[2018] 207 Comp Cas 298 (NCLT)

[Before The National Company Law Tribunal – Ahmedabad Bench]

Ashok Kumar Khosla vs. PGH International P. Ltd. and Others

The Power to review own decision is not an inherent power. It must be conferred by law either specifically or by necessary implications.

Brief facts

The application is filed under section 420(2) of the Companies Act, 2013 ("Act") read with Rule 11 of the National Company Law Tribunal Rules, 2016 ("Rules"). This application is seeking review of the NCLT order passed earlier. The applicant has the grievances against the said NCLT order. It is mentioned that the NCLT, while passing the earlier order has not taken into consideration the oral arguments and contention in written arguments on the aspects of delay and laches. Further, the NCLT has not considered the order of the NCLT, Delhi Bench in the case of (1) *Praveen Shankaralayam vs. Elan Profesional Applicances P. Ltd.* [2016] 199 Comp Cas 528 (NCLT); [2016] SCC Online NCLT 85; (2) *Esquire Electronics vs. Netherlands India Communications Enterprises Ltd.* [2016] SCC online NCLT 71 and (3) *Sanjay Agarwal vs. Meghalaya Finlease P. Ltd.* [2017] 202 Comp Cas 624 (NCLT); [2017] SCC Online NCLT 28. It is pleaded that non-consideration of oral arguments on delay and laches as well as written submission has resulted in grave miscarriage to the applicants.

The applicant has also referred to the Hon. Supreme Court Judgment in *Assistant CIT vs. Saurashtra Kutch Stock Exchange Ltd.* [2008] 305 ITR 227 (SC); [2008] 14 SCC 171, wherein Court has defined "mistake apparent from the record" and contended that non-consideration of decision of jurisdictional court can be said to be a mistake apparent from the record.

It is also contended that such mistakes can be corrected under section 420(2) of the Act. Thus, applicant has made the prayer to

recall the NCLT earlier order and pass fresh orders considering the oral arguments on delay and laches and written argument as submitted.

The arguments forwarded by the original petitioner is that NCLT order is a reasoned order based upon facts of the case and appreciation of material on record. Thus, recalling such order amounts to exercise of powers of review and NCLT has no power to review its own order.

Judgment

The NCLT has rejected the application and ruled that same cannot be considered under section 420(2) of the Act or under Rule 11 of the Rules since there is no mistake apparent from the record in the said order.

NCLT has analysed the judgment referred by the Hon'ble Supreme Court in the case of Assistant CIT *vs. Saurashtra Kutch Stock Exchange Ltd.* It has observed that said judgment also refer the another judgment in the case of *Patel Narshi Thakershi vs. Pradyamansinghji Arjunsinghji [1971] 3 SCC 844, 847*, which states that the .. Power to review is not an inherent power. It must be conferred by law either specifically or by necessary implications... The Act or Rules, there is no provision that confer power of review to NCLT. Thus, this Tribunal cannot exercise power to review by invoking Rule 11 of Rules. However, NCLT has power to correct the mistake. It has analysed the

crucial question of “mistake apparent from the record.” The NCLT has analysis of all three judgments as referred by the applicant. In the first case, it was rendered based upon the section 254(2) of the Income-tax Act. The language of said section and section 420(2) under the Act are same. In the said case, a specific judgment of the Gujarat High Court was not presented before the Tribunal when order was passed. The assessee subsequently came to know, and then he brought to the notice of the Tribunal the said judgment. The Tribunal has considered it as “mistake apparent from the record” the said judgment was also upheld by the Supreme Court. The Hon'ble Supreme Court has also analysed the judgment in the case of *Syed Yakoob vs. K. S. Radhakrishnan AIR 1964 SC 477, 479*. With reference to second judgment, NCLT has observed that in earlier order, it has mentioned that there is no finding whether there is delay and laches on the part of petitioner and same is reserved for final hearing. Further, the said judgment does not laid down any proposition of law which applies to all cases irrespective of fact situation unlike the Gujarat High Court Judgment. In case of 2nd judgment, the said case is under section 433 of the Act. Findings in the said judgment on the aspect of delay is not a proposition of law that applies to all fact situations. Reference to 3rd judgment is also for on applicability of section 433 of the Act. The entire reading of order of the Tribunal is that it will not be dismissed without there being a final hearing considering the facts and circumstances of the case.

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Day and night never come together; so desire and the Lord can never come together.

— Swami Vivekananda



CA Anand Bathiya & CA Ankit Davda

CORPORATE LAWS

Recent Developments

Decision of SEBI on recommendations of Kotak Committee Report on Corporate Governance

Corporate Governance Framework

The Corporate Governance refers to the minimum governance standards which every corporate needs to follow to protect the interests of all stakeholders.

Over the past decade, policymakers in India have been acutely conscious of the importance of corporate governance – several committees, including those under the chairmanship of Mr. Kumar Mangalam Birla, Mr. Narayana Murthy and Mr. Naresh Chandra, have made valuable recommendations which have been largely adopted. Yet, governance practices even in some of the most reputed publicly listed Indian companies have come under question on a number of dimensions.

Given recent trends of lapses of corporate governance norms on many counts which took place in varied forms, not surprisingly, there's been a renewed focus on improved corporate governance: better structures, more rigorous checks and balances, and greater independence of all key gate-keepers including boards and auditors.

From regulatory perspective, the corporate governance norms are contained in various

provisions of the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR").

Formation of Committee on Corporate Governance

On June 2, 2017, SEBI had set up a committee ("Kotak Committee") under the Chairmanship of Shri Uday Kotak, Executive Vice Chairman and Managing Director of Kotak Mahindra Bank to advise on issues relating to corporate Governance. The other members in the Kotak Committee included the representatives of government, industry, Corporate India, stock exchanges, professional bodies (including Mr. Nilesh Shivji Vikamsey, President of ICAI), Investor groups, chambers of commerce, law firms (including Ms. Zia Mody, Managing Partner of AZB & Partners and Mr. Cyril Shroff, Managing Partner of Cyril Amarchand Mangaldas), accounting firms (including Mr. N. Venkatram, Managing Partner and CEO of Deloitte India and Mr. Arun M. Kumar, Partner & CEO of KPMG India), academicians and research professionals and SEBI.

Terms of reference of the Kotak Committee

With the aim of improving standards of Corporate Governance of listed companies in India, the Kotak Committee was requested to make recommendations to SEBI on the following issues:

1. Ensuring independence in spirit of Independent Directors and their active participation in functioning of the company;
2. Improving safeguards and disclosures pertaining to Related Party Transactions;
3. Issues in accounting and auditing practices by listed companies;
4. Improving effectiveness of Board Evaluation practices;
5. Addressing issues faced by investors on voting and participation in general meetings;
6. Disclosure and transparency related issues, if any;
7. Any other matter, as the Committee deems fit pertaining to corporate governance in India.

Report of the Kotak Committee

As the Kotak Committee was requested to submit its report within four months, it submitted its report on October 5, 2017 containing the exhaustive recommendations on the burgeoning issues in the Corporate Governance in India, which is indicative of the enormous time and efforts devoted by the Kotak Committee members during the short span of four months. The report had set out the recommendations along with the rationale and the expected timeline for implementation of such recommendations. The Kotak Committee Report contains a total of 78 broad recommendations concerning the corporate governance requirements for all listed companies grouped under 8 chapters apart from other specific recommendations contained in other 3 chapters.

In order to take into consideration the views of various stakeholders, the report of the Kotak Committee was placed on the SEBI website for public comment, which were required to be submitted by November 4, 2017. Comments were received from a variety of stakeholders including industry, Government, global associations, institutional investors, lawyers, etc.

Finally, SEBI in its board meeting held on March 28, 2018, considered the Kotak Committee recommendations and the public comments received thereon. SEBI adopted threefold approach in dealing with the recommendations of the Kotak Committee viz.

- a) certain recommendations accepted without any modifications (**“Complete Acceptance”**);
- b) certain recommendations accepted with modifications (**“Partial Acceptance”**); and
- c) certain recommendations have been referred to various agencies (i.e. government, other regulators, professional bodies etc.) considering that the matters involved related to them. Such recommendations, *inter alia*, include strengthening the role of ICAI, internal financial controls, adoption of Ind-AS, treasury stock, governance aspects of PSEs, etc.

SEBI Press Release dated March 28, 2018 announcing the decisions taken in the SEBI Board Meeting just mentions few details regarding the decision of SEBI on recommendations of the Kotak Committee. The official amendments in the relevant regulations will come in due course.

Given this backdrop and space limitations, we have restricted coverage of this article for 2 critical chapters namely i) Composition and Role of the Board of Directors; and ii) Accounting and Audit Related Issues, each chapter containing 13 broad recommendations. It is to be noted that all recommendations are in the context of a listed company. The recommendations made by the Kotak Committee *vis-à-vis* the existing

regulatory requirements, the rationale for the recommendations and the SEBI decision thereon based on available information are summarised hereinafter.

I. Composition and the Role of the Board of Directors

The basic principle underlying the governance of a corporate entity is that the superintendence, control and direction of its business and affairs lie with its board of directors, with the executive management being delegated powers for

smooth and efficient operational functioning. Accordingly, the board of directors as a whole is responsible to all stakeholders for meeting the requisite standards of corporate governance.

Accordingly, the recommendations herein seek to address aspects relating *inter-alia* to the size of the board and its diversity, separation of the roles of chairperson and executive management, attendance of directors at board meetings, ongoing updation of knowledge of directors and disclosure of their skills/expertise.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
1) Minimum number of Directors on a Board			
Companies Act: Minimum 3 directors in case of a public company SEBI LODR: no specific provision	Board should consist of minimum of 6 directors	Sufficient number of directors with diverse backgrounds and skill sets are available on the board to ensure that it is able to carry out its functions effectively	Partial Acceptance: Minimum 6 directors in the top 1000 listed entities by market capitalization by April 1, 2019 and in the top 2000 listed entities, by April 1, 2020
2) Gender Diversity on Board			
At least one woman director on the board	At least one independent woman director on the board	<ul style="list-style-type: none"> Diversity, including gender diversity, is often seen to have a positive impact on the decision making processes of corporate boards To further improve gender diversity¹ 	Partial Acceptance: At least one independent woman director on the board in the top 500 listed entities by market capitalization by April 1, 2019 and in the top 1000 listed entities, by April 1, 2020

1. It seems that as many companies inducted a relative of the promoter group or the existing executive board members as a woman director on the board to comply with the requirement of having at least one woman director, the Committee has recommended appointment of an independent woman director to achieve the true intent of having gender diversity on the board as often related woman director may not effectively participate or impartially provide her views during deliberations in the board meeting.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
3) Attendance of Directors			
<p>Companies Act: The automatic vacation of the office of director if a director is absent from all meetings of the board of directors held during a 12 month period</p> <p>SEBI LODR: no specific provision</p>	<p>If a director does not attend at least half of the total number of board meetings over two financial years on a rolling basis, his / her continuance on the board should be ratified by the shareholders at the next AGM</p>	<p>Directors should attend all scheduled / minimum number of meetings</p> <ul style="list-style-type: none"> to carry out their fiduciary duties appropriately to enhance their contribution of skill, time and value towards serving the long-term interests of all stakeholders 	<p>Nothing mentioned about this in SEBI Press Release</p>
4) Disclosure of Expertise / Skills of Directors – Competency or Expertise Matrix			
<p>Disclosure of a brief profile of a director on his / her appointment, including expertise in specific functional areas. However, no specific requirement to disclose the required and available expertise of the board on a regular basis.</p>	<p>Companies should list the competencies / expertise that it believes its directors should possess <i>vis-à-vis</i> what they actually possess.</p> <p>Initially, disclosure of competencies of board members against every identified competency / expertise without disclosing individual names in the annual report for FY 2019 shall be required. However, detailed disclosures of competencies of every board member, along with their names, should be required w.e.f. March 31, 2020 viz., in Annual Report for FY 2020 onwards.</p>	<ul style="list-style-type: none"> Given the collective responsibility and the need for the board to make informed business judgment, a balanced wholesome board with complementary skill-sets amongst the directors is imperative Typically, these skill-sets would comprise technical / academic skills, general management, global business, technology, manufacturing / operations, risk management, etc. Recognizing this, board members should collectively have a wide set of skill-sets appropriate for the relevant business 	<p>Complete Acceptance.</p>

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
5) Approval for Non-executive Directors ("NED") on attaining a certain age			
<p>Companies Act: A person may be appointed / continue as Managing Director, whole-time director or manager on attaining the age of 70 years by passing a special resolution</p> <p>No such specific provision for non-executive directors.</p>	<p>A special resolution on a similar basis should be inserted for listed entities for the appointment / continuation of NEDs on attaining the age of 75 years for the relevant term.</p>	<p>While age itself may not be a determinant of efficiency or capability of a person or the basis for disqualification of a director, a higher level of shareholder endorsement may be required for directors to continue in their position beyond a certain age.</p>	<p>Nothing mentioned about this in SEBI Press Release.</p>
6) Minimum Number of Board Meetings			
<p>At least 4 meetings of the board every year with a maximum gap of 120 days between any 2 meetings</p>	<p>The minimum number of meetings of board of directors be <u>increased to 5 every year</u> and at least once a year, <u>the board shall specifically discuss</u> strategy, budgets, board evaluation, risk management, ESG (environment, sustainability and governance) and succession planning</p>	<ul style="list-style-type: none"> • 4 meetings of the board tend to focus primarily on financial results and other matters relating to regular compliance • Boards may be required to meet more frequently to focus on other critical aspects such as its management and corporate governance in order to ensure that there is adequate attention paid thereto 	<p>Nothing mentioned about this in SEBI Press Release.</p>
7) Updation of Knowledge of the Board Members			
<p>Companies Act: General provisions pertaining to the induction of independent directors.</p>	<p>At least once every year, the board of directors should be updated on regulatory and compliance changes by</p>	<ul style="list-style-type: none"> • Ever-evolving and changing regulatory environment requires constant upgradation in knowledge base 	<p>Nothing mentioned about this in SEBI Press Release.</p>

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
SEBI LODR: require familiarization of the independent directors relating to certain specified matters and that the board periodically reviews compliance reports pertaining to all laws applicable to the listed entity as well as steps taken to rectify instances of non-compliances	undertaking a formal updation programme on changes in applicable laws, regulations and compliance requirements	<p>and ignorance of the law is no excuse</p> <ul style="list-style-type: none"> • Board's supervisory role holds it ultimately accountable for unlawful actions of the company • Therefore, in order for the directors to exercise their judgment and discharge their duties with sufficient knowledge, the directors need to be kept abreast of changes in laws and compliance requirements 	
8) NED Engagement with the Management			
No specific provisions requiring mandatory engagement of the NEDs with the management	At least once every year, a company should undertake a formal interaction between the NEDs and senior management	Interactions between the NEDs and the management is critical for a better understanding by NEDs of the company's business and of the managerial capacity and capability of the company	Nothing mentioned about this in SEBI Press Release.
9) Quorum for Board Meetings			
<u>Companies Act:</u> A quorum of 1/3rd of the total strength of the board of directors or 2 directors , whichever is higher, for every board meeting	The quorum for every board meeting should be a minimum of 1/3rd of the total strength of the board of directors or 3 directors or, whichever is higher,	<ul style="list-style-type: none"> • In view of the increased obligations of the boards of listed entities, a higher quorum is required 	Quorum for Board meetings (1/3rd of the size of the Board or 3 members , whichever is higher) in the top 1000 listed entities by market capitalisation by April 1, 2019 and

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
SEBI LODR: No specific provision	including at least 1 independent director	<ul style="list-style-type: none"> In the interest of all stakeholders, especially minority shareholders, the presence of at least one independent director is required 	in the top 2000 listed entities, by April 1, 2020 ²
10) Separation of the Roles of Non-executive Chairperson and MD / CEO			
<p><u>Companies Act:</u> An individual shall not be appointed / reappointed as the chairperson of a company as well as its MD / CEO at the same time unless the articles provide otherwise or the company does not undertake multiple businesses</p> <p><u>SEBI LODR:</u> A discretionary requirement of separation of the posts of chairperson and CEO</p>	<ul style="list-style-type: none"> Listed entities with more than 40% public shareholding should separate the roles of Chairperson and MD / CEO with effect from April 1, 2020 After 2020, SEBI may examine extending the requirement to all listed entities with effect from April 1, 2022 	<ul style="list-style-type: none"> separation of powers of the chairperson (i.e. the leader of the board) and CEO / MD (i.e. the leader of the management) is seen to provide a better and more balanced governance structure by enabling better and more effective supervision of the management reducing excessive concentration of authority in a single individual creating a board environment that is more egalitarian and conducive to debate 	Separation of CEO / MD and Chairperson (to be initially made applicable to the top 500 listed entities by market capitalization w.e.f. April 1, 2020)
11) Matrix Reporting Structure			
Board of directors of a listed entity to exercise authority and assume responsibility for the overall business	a confirmation be provided by the board of a listed entity as a part of the corporate governance report that it has been responsible	<ul style="list-style-type: none"> informal matrix reporting structures may dilute the powers and the role of the board of a listed entity 	Nothing mentioned about this in SEBI Press Release.

2. SEBI Press Release does not mention anything about requirement of having at least 1 Independent Director

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
<p>and affairs of that entity and provide a detailed report (popularly referred to as the Director's Report) that sets forth details in relation to the company's business, financial performance and certain other aspects</p>	<p>for the business and overall affairs of the listed entity in the relevant financial year and that the reporting structures of the listed entity, formal and informal, are consistent with the above</p>	<ul style="list-style-type: none"> many companies (including global conglomerates) follow matrix reporting structures to meet their internal functional reporting requirements, whereby reporting happens along functional lines to relevant heads who operate at a group level (including in other jurisdictions) 	
12) Maximum Number of Directorships			
<p><u>Companies Act</u>: maximum number of public companies in which a person can be appointed as a director shall not exceed 10</p> <p><u>SEBI LODR</u>: a person shall not serve as an independent director in more than 7 listed entities and if the director is a whole-time director in one listed entity, then he / she can't serve as an independent director in more than 3 listed entities</p>	<p>Maximum number of directorships in listed entities should be reduced to 7 (irrespective of whether the person is appointed as an independent director or not).</p> <p>However, in the interest of providing adequate transition time, the maximum number of listed entity directorship held by a person be brought down to 8 by April 1, 2019 and to 7 by April 1, 2020</p>	<ul style="list-style-type: none"> multiple directorships beyond a reasonable limit may lead to a director not being able to allocate sufficient time to a particular company, thus hindering their ability to play an effective role In light of the increasing responsibilities of corporate boards and thereby increased requirement of time from directors, the maximum number of directorships should be reduced 	<p>Reduction in the maximum number of listed entity directorships from 10 to 8 by April 1, 2019 and to 7 by April 1, 2020</p>

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
13) Disclosures on Board Evaluation			
Broad provisions on board evaluation i.e. evaluation of the performance of: (i) the board as a whole, (ii) individual directors (including independent directors and Chairperson) and (iii) various committees of the board	A guidance note in the nature of a circular should be issued by SEBI, requiring disclosures on the following: <i>a) Observations of board evaluation carried out for the year</i> <i>b) Previous year's observations and actions taken</i> <i>c) Proposed actions based on current year observations."</i>	In order to strengthen disclosures on board evaluation, a guidance should be issued specifying, in particular, the certain disclosures to be made as a part of the disclosures on board evaluation.	Nothing mentioned about this in SEBI Press Release.

II. Accounting and Audit Related Issues

Financial statements are the primary document that all stakeholders rely upon. These statements are intended and expected to depict the true nature of the business and foretell its longevity. A good audit and appropriate levels of disclosures are pre-requisites for reliable financial statements. After careful consideration, the Kotak Committee made the following recommendations with a view to improving disclosures and enhancing the quality of financial statements and audit.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
1) Audit Qualifications			
<ul style="list-style-type: none"> no restriction on an auditor qualifying the accounts of a company detailed disclosures including quantification of the audit qualification by the auditor and if not possible, the management shall make an estimate 	To strengthen disclosures by requiring quantification of audit qualifications to be mandatory, with the exception being only for matters like going concern or sub-judice matters, wherein, the management will be required to provide reasons, which will be reviewed by the	<ul style="list-style-type: none"> several jurisdictions across the world forbids a listed company from filing a set of financial results / statements ('FSs') on which the auditor has issued a qualified opinion FSs not in conformity with GAAP are presumed to be inaccurate or misleading, notwithstanding explanatory disclosures 	Nothing mentioned about this in SEBI Press Release.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
which is to be reviewed by the auditor	auditors and reported accordingly	<ul style="list-style-type: none"> it may be early to entirely forbid the filing of FSs with audit qualifications in India and therefore, recommended quantification of audit qualifications to be mandatory 	
2) Independent External Opinion by Auditors (at the cost of the auditee entity)			
No specific provision.	In case an auditor is not satisfied with the views of the management or of an expert whose services have been availed by the management, the auditors shall have the right to independently obtain external opinions from experts appointed by the auditors themselves and any expenditure incurred for such purpose shall be borne by the listed entity	It is felt that in cases where the auditor does not concur with the opinion of an expert appointed by the listed entity, the auditors should have a right to obtain independent external opinions as deemed fit, at the cost of the listed entity which will help boost the independence of the auditors	Nothing mentioned about this in SEBI Press Release.
3) Group Audits			
No specific provision exists with respect to group audits under the Companies Act or SEBI LODR. However, provisions for group audits are covered under the Standards on Auditing (SA) issued by ICAI which permit the holding company auditor to place reliance on the audit performed by the auditor of the	For listed entities in India, the auditor of the holding company should be made responsible for the audit opinion of all material unlisted subsidiaries . SEBI may consider recommending to ICAI to introduce amendments to the relevant accounting / auditing standards to implement above	<ul style="list-style-type: none"> Auditing standards in India (SA 600) differ from International Standards on Auditing by allowing holding company auditor to place reliance on the audit performed by the auditor of the subsidiaries In such a case, an auditor is not fully responsible for the direction, supervision and performance of the group audit engagement as in 	Nothing mentioned about this in SEBI Press Release.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
<p>subsidiaries and provide an audit opinion on the consolidated financial statements based on the audit report provided by the other auditors</p>		<p>other jurisdictions, which is the only provision in which Indian auditing standards differed from their international counterpart</p> <ul style="list-style-type: none"> As a step in the right direction, but keeping in mind the concerns that may arise, the recommendations have been made 	
<p>4) Quarterly Financial Disclosures</p>			
<p><u>Companies Act</u>: no specific provision.</p> <p><u>SEBI LODR</u>: The detailed provisions are stated in Regulation 33 for the submission of quarterly financial results by a listed entity to the stock exchanges.</p>	<p>In order to strengthen periodic financial disclosures, it is recommended:</p> <ul style="list-style-type: none"> M a n d a t o r y submission of <u>consolidated financial results on a quarterly basis</u> apart from standalone results M a n d a t o r y <u>publishing a cash flow statement on a half-yearly basis</u> For every quarter, <u>financial information of the group, accounting for at least 80%</u> of each of the consolidated revenue, assets and profits, respectively, should have undergone limited review/audit 	<ul style="list-style-type: none"> In the interest of greater transparency at the group level, disclosure of consolidated financial results should be made mandatory on a quarterly basis Publishing of a cash flow statement will provide timely financial information to stakeholders which are otherwise not available in quarterly financial results Audit/limited review of the listed entity does not often take into account a substantial portion of the group business since the accounts of the underlying subsidiaries often do not undergo limited review / audit The figures of the last quarter are the balancing figures between audited figures in respect of the full financial year and the 	<p>M a n d a t o r y disclosure of consolidated quarterly results with effect from FY 2019-20</p>

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
	<ul style="list-style-type: none"> any material adjustments made in the results of the last quarter which pertain to earlier periods should be disclosed as a note in the financial results 	published year-to date figures up to the third quarter, therefore, any material adjustments made in 4th quarter pertaining to earlier periods should invariably be disclosed for better understanding.	
5) Internal Financial Controls			
<p><u>Companies Act</u>: requires the auditor to report on Internal Financial Controls (‘IFC’)</p> <p>Section 129(4) of the Companies Act states that the provisions of the Act applicable to the preparation, adoption and audit of the FSs of a holding company shall, <i>mutatis mutandis</i>, apply to the consolidated financial statements</p> <p>However, ICAI, through a guidance, has restricted the reporting requirements for an auditor of the consolidated financial statements, to the IFC at the Indian subsidiaries only.</p>	<ul style="list-style-type: none"> IFC reporting requirements be made applicable to the entire operations of the group and not just to the Indian operations Initially, this be made applicable only to listed entities with net-worth of Rs. 1000 Cr. & above No amendments required to SEBI LODR Regulations, but SEBI should take up above recommendation with ICAI 	<ul style="list-style-type: none"> While reporting on the consolidated financial statements, the auditors of companies in India are required to report on the IFCs for Indian companies only and their foreign subsidiaries are exempt unlike in other markets, where the requirement applies to the entire group Measure to tighten the reporting requirements with a view to achieve better governance and transparency in disclosures 	Referred recommendations to various agencies – possibly to ICAI
6) Disclosure of Reasons of Resignation of Auditors			
<p><u>Companies Act</u>: Upon the resignation of auditors, reasons for such resignation needs to be filed with the company and the RoC</p>	<ul style="list-style-type: none"> For the sake of greater transparency, it is important for companies to disclose the 	<ul style="list-style-type: none"> Auditors are critical gatekeepers of corporate governance standards. Their role in ensuring that the financial statements of the entity 	Complete Acceptance

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
SEBI LODR: A change in auditor is a deemed material event and disclosure is required to be made to the exchanges, there is no specific provision for disclosure of detailed reasons for such change	<p>reasons for the resignation of its audit firm</p> <ul style="list-style-type: none"> Audit firms too must be encouraged to truthfully disclose the reasons for their resignation as audit firms must see this disclosure as part of their fiduciary responsibility towards the shareholders 	<p>provide a true and fair view of the affairs of the entity makes them critical to the corporate governance agenda.</p> <ul style="list-style-type: none"> The resignation of an auditor before the expiry of the term may be a cause for concern and therefore, detailed disclosure of reasons for such resignation is essential. 	
7) Disclosures on Audit and Non-audit Services Rendered by the Auditor along with network firms			
<p><u>Companies Act:</u> permits auditors to perform only those non-audit services as approved by the board / Audit Committee and specifically prohibits certain services that can be provided</p> <p>SEBI LODR: Audit committee approves payment to statutory auditors for any other services rendered by the statutory auditors</p>	<p>The total fee paid to auditor and all entities on the network firms / network entity of which the auditor is a part shall be disclosed by the listed entity in its annual report on a consolidated basis (i.e. paid by the listed entity and its subsidiaries)</p>	<ul style="list-style-type: none"> To improve transparency and disclosure requirements. <p><i>Further, this will provide an eye view on the concentration of financial interests of the auditor part of network firms in a particular client group and provide a clue towards existence of possible conflict of interest situation.</i></p>	<p>Nothing mentioned about this in SEBI Press Release.</p>
8) Audit Quality Indicators			
No specific provision.	Public disclosure of certain audit quality indicators of the auditors will enable transparency and comparison of the audit quality of different auditors.	The quality of audit / auditors can be judged through various indicators such as workforce metrics, skill-development and training of audit team, quality metrics such as audit restatements, trends in audit	Nothing mentioned about this in SEBI Press Release.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
	<p>There is no specific amendment required to SEBI LODR Regulations.</p> <p>SEBI to take up the above recommendation with ICAI.</p>	<p>metrics such as billable hours and audit fines, legal actions and fines against the firm, independence metrics such as client and group concentration, use of technology, etc., many of the aforesaid indicators are already a part of ICAI's peer review system.</p>	
9) Disclosures of Credentials and Audit Fee of Auditors			
<p><u>Companies Act:</u> No specific provision on the subject matter except disclosure on auditors remuneration in FSs.</p> <p><u>SEBI LODR:</u> No specific disclosures requirement in relation to appointment of auditors, however, Regulation 4(1)(b) imposes an obligation on the listed entity to ensure that the audit is conducted by an independent, competent and qualified auditor.</p>	<p>The notice of an AGM which contains an agenda of appointment / re-appointment of the statutory auditor(s) shall include the following disclosures as a part of explanatory statement:</p> <p>(a) Proposed fees payable to the statutory auditor(s) along with terms of appointment and in case of a new auditor, any material change in the fee payable to such auditor from that paid to the outgoing auditor along with the rationale for such change;</p> <p>(b) Basis of recommendation for appointment including the details in relation to and credentials of the statutory auditor(s) proposed to be appointed.</p>	<ul style="list-style-type: none"> • To enable shareholders to take informed decisions on the appointment of auditors • As the audit fee charged by some of the firms is not on parity with benchmarks such as percentage of total assets, etc. and in order to improve transparency, the proposed audit fees must be disclosed in the notice and if there is any material change in the fees paid to a new auditor as compared to the current audit fee, the rationale for the same must be provided 	<p>C o m p l e t e Acceptance.</p>

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
10) Ind-AS Adoption			
MCA and SEBI have specified timelines for listed entities and certain other entities for adoption of Ind-AS. The listed entities (other than banks, NBFCs and insurance companies) are currently required to comply with the provisions of Ind-AS in preparation of their financial statements and audit.	Recommended full implementation of Ind-AS including to Banks, NBFCs and Insurance Companies as currently scheduled without any permitting or allowing any extension. Therefore, SEBI should take up the above recommendation with the relevant authorities / regulators, as necessary.	<ul style="list-style-type: none"> Listed banks, NBFCs and insurance companies are important financial intermediaries, critical to the sanctity of India's financial markets and its growth; and Given the principle-based rules of Ind-AS and resultant disclosures in financial statements, full implementation of Ind-AS for all listed entities is critical 	R e f e r r e d r e c o m m e n d a t i o n s t o v a r i o u s a g e n c i e s – p o s s i b l y t o M C A , R B I , a n d I R D A .
11) Strengthening Monitoring, Oversight and Enforcement by SEBI			
A. Review of Audit Qualifications			
Presently, no specific requirement. Earlier, SEBI LODR had detailed provisions on the review of audit qualifications by the Qualified Audit Report Review Committee (QARC) and further reference of the same to the Financial Reporting Review Board (FRRB) of ICAI.	QARC mechanism may be revived or any other similar mechanism may be devised wherein audit qualifications are examined in greater detail and further process to be followed by such committee should be time bound	Any audit qualification needs detailed scrutiny for placing reliance on such FSs.	N o t h i n g m e n t i o n e d a b o u t t h i s i n S E B I P r e s s R e l e a s e .
B. Powers of SEBI with Respect to Auditors and Other Statutory Third Party Fiduciaries for Listed Entities			
ICAI, as the professional services regulator, regulates the profession of chartered accountants and has a mechanism in place for disciplinary proceedings against them.	SEBI should have clear powers to act against auditors and other third party fiduciaries with statutory duties under securities law (<i>as defined under SEBI LODR Regulations</i>), subject to appropriate	<ul style="list-style-type: none"> Such powers to SEBI are essential given SEBI's mandate to protect the interests of investors in the securities market and regulating listed entities. 	N o t h i n g m e n t i o n e d a b o u t t h i s i n S E B I P r e s s R e l e a s e .

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
Under the SEBI Act or Regulations framed thereunder, there is no provision which provides specific penal powers to SEBI in relation to auditors.	safeguards. This power should be provided in case of gross negligence as well, and not just in case of fraud / connivance.	<ul style="list-style-type: none"> Such powers ought to extend to act against the impugned individual(s), as well as against the firm in question with respect to their functions concerning listed entities 	
12) Strengthening the Role of ICAI			
ICAI Act permits ICAI to punish a defaulting member or levy a penalty on the member not exceeding ₹ 5 lakh. It does not permit ICAI to punish or impose penalties on firms.	<p>ICAI may be given powers to increase the scope of punishment as well as the penalty amount as follows:</p> <ul style="list-style-type: none"> On the member - penalty of up to ₹ 1 Cr.; On the audit firm-punishment or impose penalties of up to ₹ 5 Cr. in case of repeated violations (that is, where the number of violations exceed 3) <p>Further, there are certain recommendations like increased disclosure, formation of special teams etc. in relation to the enforcement / disciplinary process of the ICAI.</p>	<ul style="list-style-type: none"> Reliable financial statements are at the core of corporate governance and therefore the fiduciary role of the auditor is crucial. Hence there needs to be sufficient deterrence to ensure this objective in the interest of corporate governance. In this context, the current maximum amount for penalty under the ICAI Act of ₹ 5 lakh is too low to act as a deterrent. Therefore, in the interest of enhancing governance of listed entities, ICAI may be given powers to increase the scope of punishment as well as the penalty amount. 	Nothing mentioned about this in SEBI Press Release.

Current regulatory provisions	Recommendations	Rationale	SEBI's decision
13) Strengthening the Independent Functioning of Quality Review Board ('QRB')			
No specific provision on QRB under the Companies Act or SEBI LODR Regulations	<ul style="list-style-type: none"> • QRB should be further strengthened to meet the independence criteria laid down by the International Forum of Independent Audit Regulators (IFIAR) and should become a member of IFIAR at the earliest • Reasons for disagreement between the ICAI and the QRB should be recorded in writing and communicated to QRB for improving transparency in functioning. 	<ul style="list-style-type: none"> • Most major economies in the world have implemented systems of independent oversight for the auditors of listed companies that provide confidence to shareholders and stakeholders • QRB is mandated to conduct such reviews and has now started carrying out reviews of audits performed by various auditors. Therefore, strengthening the role of QRB assumes significance. 	Nothing mentioned about this in SEBI Press Release.

It may be noted that ICAI, represented by its President on the Committee, has objected to recommendations No. 11, 12 and 13.

Given the exhaustive detailing done while giving recommendations on each subject matter, we must appreciate the enormous efforts, valuable time and contributions made by the Kotak Committee in further uplifting the corporate governance standards in India. Given the bold recommendations made by the Kotak Committee on certain aspects, it is bound to invite certain difficulties including certain genuine concerns expressed by interested stakeholders. To conclude, we would like to quote Mr. Uday Kotak which appears in the Preface to the Kotak Committee Report: *"It is an endeavour to facilitate the true spirit of governance. Under the leadership of a vigilant market regulator - SEBI, and with the persistent efforts of key stakeholders, corporate governance standards in India will continue to improve. A stronger corporate governance code will enhance the overall confidence in Indian markets and in India."*

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS

FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circular and notification issued by RBI.

1. Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions

RBI, based on the report of the working group to review the guidelines for Hedging of Commodity Price Risk by Residents in Overseas Markets set up under the Chairmanship of Shri Chandan Sinha, draft directions for hedging of commodity price risk and freight risk were released for comments on January 12, 2018 to amend the regulations contained under Notification No. FEMA 25 the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000.

Based on the comments received on the report and the feedback to the draft directions, RBI has notified the Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions, 2018 which shall come into force from April 1, 2018.

Transition Provision: Residents hedging their commodity price risk and freight risk under a specific approval from RBI given under the approval route based on the previous set of

guidelines would be permitted to continue hedging under the said approval till June 30, 2018 or the last date specified in the approval, whichever is earlier.

The relevant instructions on the subject contained in the following circulars stand withdrawn as on April 1, 2018:

- A. P. (DIR Series) Circular No. 68 dated January 17, 2012 on "Risk Management and Inter-Bank Dealings - Commodity Hedging."
- Section E and F of A. P. (DIR Series) Circular No. 32 dated December 28, 2010 on "Comprehensive Guidelines on Foreign Exchange Derivatives and Overseas Hedging of Commodity Price and Freight Risks" and the relevant appendices.
- A. P. (DIR Series) Circular No.35 dated November 10, 2008 on "Remittance related to Commodity Derivative Contract Issuance of Standby Letter of Credit / Bank Guarantee."

The salient features of the Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions, 2018 are as follows:-

- a) AD Banks can now allow **eligible entities** as defined under the guidelines to hedge their **Direct as well as Indirect exposure** to Commodity Price Risk for **eligible commodities** (in case of direct exposure to commodity price risk, all commodities except Gold, Gems & Precious Stones) in **Permitted Generic as well as Structured products** and allow remittances subject to other compliance with operational guidelines provided under the directions.
- b) **Standby Letters of Credit (SBLC) / Guarantees** – Banks are permitted to issue Standby Letters of Credit (SBLC) / Guarantees, for a maximum period of one year, on behalf of their clients in lieu of making a remittance of margin money for commodity hedging transactions entered into by their customers. Banks should ensure that these SBLCs / Guarantees are used by their clients for the intended purposes.
- c) **Realisation and repatriation of foreign exchange** – Realisation and repatriation of foreign exchange due or accruing to an eligible entity resulting from permitted transactions under this direction shall be guided by the provisions of the Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015.

[RBI/2017-18/138 A. P. (DIR Series) Circular No.19 dated 12th March 2018]

(Comments: Allowing eligible entities to hedge their Commodity Price Risk and Freight Risk is of great benefit to the traders. The benefit is available to all resident entities other than individuals. As part of the compliance process, banks are required to obtain an annual certificate from the statutory auditors of the entity confirming that the hedge transactions and the margin remittances are in line with the exposure of the entity. The statutory auditor is also required to comment on the risk

management policy of the entity for hedging exposure to commodity price risk and freight risk and the appropriateness of the methodology to arrive at the quantum of these exposures)

2. Discontinuance of Letters of Undertaking (LoUs) and Letters of Comfort (LoCs) for Trade Credits

Currently, in terms of paragraph 2 of A.P. (DIR Series) Circular No. 24 dated November 1, 2004 and paragraph No. 5.5 of Master Direction No. 5 dated January 1, 2016 on 'External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers', as amended from time-to-time, AD Category I banks were granted general permission to approve trade credits through issuance Guarantee/Letter of Undertaking (LoU) /Letter of Comfort (LoC) for imports into India up to USD 20 million per import transaction for import of all items permissible under the EXIM Policy.

On a review, RBI has instructed AD Banks to discontinue the practice of issuance of LoUs/LoCs for Trade Credits for imports into India by AD Category-I banks with immediate effect.

Issuance of Letters of Credit and Bank Guarantees for Trade Credits for imports into India will continue subject to compliance with the provisions contained in Department of Banking Regulation Master Circular No. DBR. No. Dir. BC.11/13.03.00/2015-16 dated July 1, 2015 on "Guarantees and Co-acceptances", as amended from time-to-time.

[RBI/2017-18/139 A.P. (DIR Series) Circular No.19 dated 13th March 2018] / Master Direction - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers (updated as on March 16, 2018)

(Comments: Discontinuance of LoUs and LoCs for Trade Credits is direct result of the Punjab

National Bank Fraud, this move will improve the diligence of the banks and make the banking systems more resistant towards fraud.)

3. Foreign Exchange Management (Cross Border Merger) Regulations, 2018

Mandated by Section 234 of the Companies Act, 2013, Ministry of Corporate Affairs had issued Companies (Compromises, Arrangements and Amalgamation) Amendment Rules, 2017 on April 13, 2017 to operationalize this section.

To address FEMA issues, RBI on 26th April, 2016 placed on its website the draft guidelines for cross-border merger, demerger, amalgamation and arrangement between Indian companies and foreign companies pursuant to the Rules notified by MCA which have now been notified as "Foreign Exchange Management (Cross-Border Merger) Regulations".

The salient features of the regulations are as follows:

A. Inbound Merger – Merger or amalgamation of a Foreign Company with an Indian Company

In case of cross-border mergers where the resultant company is an Indian company, it is allowed to issue or transfer any security and/or a foreign security, as the case may be, to a person resident outside India in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in "Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India)" Regulations, 2017, provided –

- Where the foreign company is a JV/ WOS of the Indian company, it shall comply with the conditions prescribed for transfer of shares of such JV/ WOS by the Indian party as laid down in Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004.

- Where the inbound merger of the JV/ WOS results into acquisition of the step down subsidiary of the JV/ WOS of the Indian party by the resultant company, then such acquisition should be in compliance with Regulations 6 and 7 of "Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004".

- An office outside India of the foreign company, pursuant to the sanction of the Scheme of cross border merger shall be deemed to be the branch/office outside India of the resultant company and may undertake any transaction as permitted to a branch/office under the aforesaid Regulations in accordance with the "Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015".

- The guarantees or outstanding borrowings of the foreign company from overseas sources which become the borrowing of the resultant company or any borrowing from overseas sources entering into the books of resultant company shall conform, within a period of two years, to the External Commercial Borrowing norms or Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 or Foreign Exchange Management (Borrowing or Lending in Rupees) Regulations, 2000 or Foreign Exchange Management (Guarantee) Regulations, 2000, as applicable.

The guidelines are subject to the condition that no remittance for repayment of such liability is made from India within such period of two years;

It is provided that the conditions with respect to end use shall not apply.

- The resultant company may acquire and hold any asset outside India which an Indian company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.
- Where the asset or security outside India is not permitted to be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.
- The resultant company may open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross border merger for a maximum period of two years from the date of sanction of the Scheme by NCLT.

B. Outbound Merger- Merger or Amalgamation of an Indian Company with a Foreign Company:

In case of cross border mergers where the resultant company is a foreign company, the same is permitted subject to the following–

- A person resident in India may acquire or hold securities of the resultant company in accordance with the Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2004.
- A resident individual may acquire securities outside India provided that the fair market value of such securities is within the limits prescribed under the Liberalised Remittance Scheme laid down in the Act or rules or regulations framed thereunder.
- An office in India of the Indian company, pursuant to sanction of the Scheme of cross-border merger, may be deemed to be a branch office in India of the resultant company in accordance with the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. Accordingly, the resultant company may undertake any transaction as permitted to a branch office under the aforesaid Regulations.
- The guarantees or outstanding borrowings of the Indian company which become the liabilities of the resultant company shall be repaid as per the Scheme sanctioned by the NCLT in terms of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

It is provided that the resultant company shall not acquire any liability payable towards a lender in India in Rupees which is not in conformity with the Act or rules or regulations framed thereunder.

It is provided further that a no-objection certificate to this effect should be obtained from the lenders in India of the Indian company.

- The resultant company may acquire and hold any asset in India which a foreign company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.
- Where the asset or security in India cannot be acquired or held by the

resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated outside India immediately through banking channels. Repayment of Indian liabilities from sale proceeds of such assets or securities within the period of two years shall be permissible.

- The resultant company may open a Special Non-Resident Rupee Account (SNRR Account) in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 for the purpose of putting through transactions under these Regulations. The account shall run for a maximum period of two years from the date of sanction of the Scheme by NCLT.

Valuation

The valuation of the Indian company and the foreign company shall be done in accordance with Rule 25A of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

Miscellaneous

- (1) Compensation by the resultant company, to a holder of a security of the Indian company or the foreign company, as the case may be, may be paid, in accordance with the Scheme sanctioned by the NCLT.
- (2) The companies involved in the cross border merger shall ensure that regulatory actions, if any, prior to merger, with respect to non-compliance, contravention, violation, as the case may be, of the Act or the Rules or the Regulations framed thereunder shall be completed.

Reporting

The resultant company and/or the companies involved in the cross-border merger shall be

required to furnish reports as may be prescribed by the RBI.

Deemed approval

- (1) Any transaction on account of a cross-border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.
- (2) A certificate from the Managing Director/ Whole Time Director and Company Secretary, if available, of the company(ies) concerned ensuring compliance to these Regulations shall be furnished along with the application made to the NCLT under the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

[GSR No. 244E / FEMA Notification No. 389 dated 20th March, 2018]

(Comments: These regulations have finally seen the light of day after almost a 5 year wait. The regulations will facilitate international mergers and acquisitions and boost the economy. The concept of Deemed Approval in cases where these regulations are complied with is welcome step as it would reduce the hardship and time taken in approval process and also reduce procedural burden on the RBI. Also, providing a two year window to comply with the transitional provisions in these regulations is a beneficial provision and gives the entities enough time to comply with all the regulations of FEMA as well as Companies Act, 2013 and the directions of the NCLT.

4. Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 – Issue of Notification No. 21(R)

RBI has issued updated Notification to update regulation relating to acquisition & transfer of Immovable properties in India which consolidates earlier notifications & circulars issued by the RBI under the revised regulations.

While updating the regulations, under Regulation 7, RBI has also allowed acquisition of immovable property by Long-Term Visa Holders being citizen of Afghanistan, Bangladesh or Pakistan belonging to minority communities in those countries, namely, Hindus, Sikhs, Buddhists, Jains, Parsis and Christians who are residing in India and have been granted a Long Term Visa (LTV) by the Central Government only one residential immovable property in India as dwelling unit for self-occupation and only one immovable property for carrying out self-employment subject to the following conditions:

- (a) the property should not be located in and around restricted/ protected areas so notified by the Central Government and cantonment areas;
- (b) the person submits a declaration to the Revenue Authority of the district where the property is located, specifying the source of funds and that he/ she is residing in India on LTV;
- (c) the registration documents of the property should mention the nationality and the fact that such person is on LTV;
- (d) the property of such person may be attached/ confiscated in the event of his/ her indulgence in anti-India activities;
- (e) a copy of the documents of the purchased property shall be submitted to the Deputy Commissioner of Police (DCP)/ Foreigners Registration Office (FRO)/ Foreigners Regional Registration Office (FRRO) concerned and to the Ministry of Home Affairs (Foreigners Division);
- (f) such person shall be eligible to sell the property only after acquiring Indian citizenship. However, transfer of the property before acquiring Indian

citizenship shall require prior approval of DCP/FRO/FRRO concerned.

[GSR No. 280E / FEMA 21 (R) dated 26th March 2018]

5. Changes in FDI Policy – Amendment in Notification No. 20(R) dated 7th November, 2017– Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2018

The Government of India has reviewed the existent FDI policy on various sectors and made the following changes-

- A. **Amendment to Regulation 16.B which specifies Permitted sectors, entry routes and sectoral caps for total foreign investment**
 - The existing sub-regulation 5 will be substituted by the following:-

Existing Provision	Amended provision
Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies, will require prior approval of the Government. A core investment company (CIC) will have to additionally follow the Reserve Bank’s regulatory framework for CICs	<ul style="list-style-type: none"> a. Foreign Investment in investing companies not registered as Non-Banking Financial Companies with the Reserve Bank and in core investment companies (CICs), both engaged in the activity of investing in the capital of other Indian entities, will require prior Government approval. b. Foreign investment in investing companies registered as Non-Banking Financial Companies (NBFCs) with the Reserve Bank, will be under 100% automatic route

- After the existing sub-regulation 7, the following new sub-regulation (8) shall be inserted namely,

(8) Wherever the person resident outside India who has made foreign investment specifies a particular auditor/ audit firm having international network for the audit of the Indian investee company, then audit of such investee company shall be carried out as joint audit wherein one of the auditors is not part of the same network.
- The existing SL. No 9.3(a) of Para 9.3 dealing with Air Transport Services shall be substituted by the following, namely:

Existing Provision:-

(a) (i) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline	49% (100% for NRIs and OCIs)	Automatic
(ii) Regional Air Transport Service		

Revised Provision:-

(a) (i) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline	100%	Automatic up to 49% Government route beyond 49% (Automatic up to 100% for NRIs and OCIs)
(ii) Regional Air Transport Service		

- In Sl. No 9.5 which provides other conditions for Civil Aviation Sector, after clause (c), the following shall be inserted, namely:

(d) In addition to the above conditions, foreign investment in M/s. Air India Limited shall be subject to the following conditions:

 - (i) Foreign investment in M/s. Air India Ltd., including that of foreign airline(s), shall not exceed 49% either directly or indirectly
 - (ii) Substantial ownership and effective control of M/s Air India Ltd. shall continue to be vested in Indian Nationals.
- In Sl. No 9.5, Note (3) shall be deleted which provided exclusion of M/s. Air India Ltd. from the guidelines.
- In Sl. No. 10.2 under the FDI Policy for **Construction Development: Townships, Housing, Built-up infrastructure Sector**, after Note 6, a new Note 7 shall be inserted, namely:

(7) Real estate broking services shall be excluded from the definition of “real estate business” and 100% foreign investment is allowed in real estate broking services under automatic route.”
- In Sl. No. 15.3, dealing with Single Brand Product Retail Trading under FDI Policy for **Trading Sector**, column Entry route, the words, “Automatic up to 49%; Government route beyond 49%” shall be substituted by the words “Automatic”.
- In Sl. No. 15.3.1, providing other conditions for FDI in Single Brand Product Retail Trading, the existing clause (d) shall be substituted by the following, namely:

Existing	Amended Provision
(d) A person resident outside India, whether owner of the brand or otherwise, shall be permitted to undertake ‘single brand’ product retail trading in the country for the specific brand, directly or through a legally tenable agreement, with the brand owner for undertaking single brand product retail trading. The onus for ensuring compliance with this condition will rest with the Indian entity	(d) A person resident outside India, whether owner of the brand or otherwise, shall be permitted to undertake ‘single brand’ product retail trading in the country for the specific brand, either directly by the brand owner or through a legally tenable agreement executed between the Indian entity undertaking single brand

Existing	Amended Provision
carrying out single-brand product retail trading in India. The investing entity shall provide evidence to this effect at the time of seeking approval, including a copy of the licensing/ franchise/ sub-licence agreement, specifically indicating compliance with the above condition. The requisite evidence should be filed with the RBI for the automatic route and the Government for cases involving approval.	retail trading and the brand owner.

- In Sl. No 15.3.1, clause (g) and clause (h) shall be deleted.
- In Sl. No 15.3.1, after the omitted clause (h), the following shall be inserted, namely
 “(i) Single brand retail trading entity shall be permitted to set off its incremental sourcing of goods from India for global operations during initial 5 years, beginning 1st April of the year of the opening of first store, against the mandatory sourcing requirement of 30% of purchases from India. For this purpose, incremental sourcing shall mean the increase in terms of value of such global sourcing from India for that single brand (in INR terms) in a particular financial year from India over the preceding financial year, by the non-resident entities undertaking single brand retail trading, either directly or through their group companies. After completion of this 5 years period, the SBRT entity shall be required to meet the 30% sourcing norms directly towards its India’s operation, on an annual basis.”
- In SL. No 15.3.1, Note 2 and Note 3 shall be deleted.
- In SL. No 15.3.1, the existing Note 5 shall be substituted by the following, namely:

“Sourcing norms will not be applicable up to three years from commencement of the business i.e., opening of the first store for entities undertaking single brand retail trading of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible. Thereafter, condition mentioned at 15.3.1(e) above will be applicable. A Committee under the Chairmanship of Secretary, DIPP, with representatives from NITI Aayog, concerned Administrative Ministry and independent technical expert(s) on the subject will examine the claim of applicants on the issue of the products being in the nature of 'state-of-art' and 'cutting-edge' technology where local sourcing is not possible and give recommendations for such relaxation.”

- In Sl. No. 16.3 providing Other Conditions in Pharmaceutical sector, in Note 2, in clause (a), in sub-clause (ab), the existing word “handicap” shall be substituted by the word, “disability”.
- In Sl. No. 16.3, providing Other Conditions in Pharmaceutical sector, in Note 2, clause (c) shall be substituted by the following, namely:
 “in-vitro diagnostic device which is a reagent, reagent product, calibrator, control material, kit, instrument, apparatus, equipment or system, whether used alone or in combination thereof intended to be used for examination and providing information for medical or diagnostic purposes by means of examination of specimens derived from the human bodies or animals.”
- In Sl. No. 16.3, providing Other Conditions in Pharmaceutical sector, the existing Note 3 shall be deleted.
- In Sl. No. F.6.1 providing Other Conditions in Financial Services sector, the existing clause (a) shall be deleted.

3. Amendment to Schedule 1

In Schedule 1,

- The existing Para 1(4), shall be substituted by the following namely:

Existing	Amended
(4) An Indian company may issue capital instruments to a person resident outside India against swap of capital instruments if the Indian investee company is engaged in an automatic route sector.	(4) An Indian company may issue, subject to compliance with the conditions prescribed by the Central Government and/ or the Reserve Bank from time to time, capital instruments to a person resident outside India, if the Indian investee company is engaged in an automatic route sector, against: <ul style="list-style-type: none"> (a) Swap of capital instruments; or (b) Import of capital goods/ machinery/ equipment (excluding second-hand machinery); or (c) Pre-operative/ pre-incorporation expenses (including payments of rent etc.). Provided Government approval shall be obtained if the Indian investee company is engaged in a sector under Government route. The applications for approval shall be made in the manner prescribed by the Central Government from time to time.

- The existing Para 1(6), shall be deleted:

[GSR No. 289E / FEMA 20 (R)(1) dated 26th March 2018]

We have discussed below few recent compounding orders issued by RBI:-

A. Accounts in India by Person Resident Outside India:**6. C.A. No.4577/2017 & 4578/2017 in the matter of Edunetwork Pvt Ltd and Gaurav Bamania (amount imposed under the compounding orders dated 2-2/2018 & 30-1/2018 respectively – ₹ 26,530/- each)****Facts of the Case**

Mr. Gaurav Bamania, an NRI, paid the consideration amount of ₹ 56,850 on August 3, 2015 for subscribing to 3,790 shares of an Indian company Edunetwork Pvt Ltd. Mr. Gaurav Bamania paid the consideration amount through his resident account and not by way of inward remittance through normal banking channel from abroad or out of funds held in NRE/FCNR/NRO account maintained with a bank in India.

Edunetwork Pvt. Ltd. issued such shares to Mr. Gaurav Bamania upon receipt of aforesaid consideration.

Contravention:

The contravention sought to be compounded related to the following:

- Payment of consideration towards investment in Indian company by an NRI through a resident account: Para 8(a) of Schedule 3 of erstwhile Foreign Exchange Management (Deposit) Regulations, 2000 notified *vide* Notification No. FEMA 5/2000-RB dated May 3, 2000 stated as follows - "When a person resident in India leaves India for a country (other than Nepal or Bhutan) for taking up employment, or for carrying on business or vocation outside India or for any other purpose indicating his intention to stay outside India for an uncertain period, his existing account should be designated as a Non-Resident (Ordinary) account."

- Issue of shares to NRI upon receipt of consideration from a resident account without permission from RBI: Erstwhile Para 3 of Schedule 4 of erstwhile Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations, 2000 notified *vide* Notification No. FEMA 20/2000- RB dated May 3, 2000 stated as follows: "The consideration for investment under this Schedule shall be paid by way of inward remittance through normal banking channel from abroad or out of funds held in NRE/FCNR/NRO account maintained with a bank in India." Further, Regulation 4 of erstwhile FEMA 20 stated as follows: "Save as otherwise provided in the Act or Rules or Regulations made thereunder, an Indian entity shall not issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person:

Provided that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an entity to issue any security to a person resident outside India or to record in its books transfer of security from or to such person, subject to such conditions as may be considered necessary."

(Comments:

- *Though Foreign Exchange Management (Deposit) Regulations as well as Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations have been replaced by revised regulations; Para 9(a) of Schedule 3 of extant FEMA 5(R)/2016-RB dated 1/4/2016 corresponds to Para 8(a) of Schedule 3 of erstwhile FEMA 5/2000-RB dated May 3, 2000, whereas Para A.3 of Schedule 4 and Regulation 4 of extant FEMA 20(R)/2017-RB dated 07/11/2017 correspond to Para 3 of Schedule 4 and Regulation 4 of erstwhile FEMA 20/2000-RB dated May 3, 2000.*

- *Care needs to be taken by emigrating Indians to immediately re-designate their resident savings bank account into NRO account upon leaving India.*
- *One may also notice in this compounding order that RBI has levied penalty for the intervening period starting with date of investment into Indian company till date of regularisation by RBI and not from the date of the individual becoming NRI.*
- *It may also be noted that for the same transaction, RBI has levied penalty upon both parties to the transaction.)*

B. Foreign Investment in India

7. C.A. No. 713/2017 in the matter of M/s. Icube Analytics and Data Services Private Limited (Amount imposed under the compounding order dated 8-1-2018 – ₹ 11,670/-)

Facts of the Case

M/s. Icube Analytics and Data Services Private Limited has allotted 8,421 equity shares to M/s Think and Tell Enterprises, France and 10,526 equity shares to M/s Carcasses Alain, France on December 1, 2014 of ₹ 10/- each. The Reserve Bank of India has duly acknowledged the issue on April 6, 2016. Shri Tejpal Mehta purchased these equity shares from them on October 10, 2015. The company reported in the Form FC-TRS on July 25, 2017 with a corresponding delay of 1 year 7 months 16 days approximately whereas the transfer of shares was taken on record by the company on March 31, 2016 without obtaining duly acknowledged / certified Form FC-TRS by the AD bank.

Contravention:

The contravention sought to be compounded relates to the following:

- Taking on record by the company, the transfer of shares by resident to non-

resident without obtaining certified Form FC-TRS: Regulation 4 of erstwhile Foreign Exchange Management (Transfer of issue of Security by a Person Resident outside India) Regulations, 2000 notified *vide* Notification No. FEMA 20/RB-2000 dated May 3, 2000 stated as follows: "Save as otherwise provided in the Act or Rules or Regulations made thereunder, an Indian entity shall not issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person:

Provided that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an entity to issue any security to a person resident outside India or to record in its books transfer of security from or to such person, subject to such conditions as may be considered necessary."

(Comments:

- *Though Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations have been replaced by revised regulations Regulation 4 of extant FEMA 20(R)/2017-RB dated 07/11/2017 corresponds to Para 3 of Schedule 4 and Regulation 4 of erstwhile FEMA 20/2000- RB dated May 3, 2000.*
- *The primary onus of reporting and submission of Form FC-TRS rests upon the resident transferor/transferee (viz. the resident individual in this case). Nonetheless, RBI has levied penalty upon the Indian company which has taken the transfer on record in its books without obtaining certified Form FC-TRS)*

8. C.A. No. 4548/2017 in the matter of Diabu Diamond Tools (India) Pvt. Ltd. (Amount imposed under the

compounding order dated 31-1-2018 – ₹ 1,11,610/-)

Facts of the Case

The Indian company had allotted 42,126 equity shares on 1-11-2013 to Diabu Germany (parent company) in lieu of supply of raw material for ₹ 89,21,042 and bank charges of ₹ 5,57,389, totalling ₹ 94,78,431. The allotment of 42,126 shares were entered into the books of the company without the approval of RBI.

Contravention

The contravention sought to be compounded relates to the following:

- Issuance of shares to the foreign entity without obtaining prior approval RBI: Regulation 4 of erstwhile Foreign Exchange Management (Transfer of issue of Security by a Person Resident outside India) Regulations, 2000 notified *vide* Notification No. FEMA 20/RB-2000 dated May 3, 2000 stated as follows: "Save as otherwise provided in the Act or Rules or Regulations made thereunder, an Indian entity shall not issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person:

Provided that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an entity to issue any security to a person resident outside India or to record in its books transfer of security from or to such person, subject to such conditions as may be considered necessary."

(Comments:

- *Though Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations have been replaced by revised regulations; Regulation 4 of extant FEMA 20(R)/2017-RB dated 7-11-2017 corresponds to Para*

3 of Schedule 4 and Regulation 4 of erstwhile FEMA 20/2000- RB dated May 3, 2000.

- *One needs to bear in mind that although issue of capital instruments for consideration other than cash has been recently allowed under automatic route as explained above under Changes to FDI Policy introduced vide Notification FEMA 20(R)(1)/2018-RB dated 26th March 2018, it is still restricted in scope to specific instances being (a) swap of capital instruments; (b) import of capital goods / machinery / equipment (excluding second-hand machinery); (c) pre-operative / pre-incorporation expenses (including payment of rent etc.). Accordingly, issue of capital instruments in lieu of any other expenses (including supply of raw material and bank charges as in this case) would still need approval from RBI under extant FEMA 20(R)/2017-RB dated 7-11-2017 as amended from time to time.)*

9. C.A. No. 4536/2017 & 4542/2017 in the matter of Shri Mahesh Ramakrishnan & Shri S. Ramakrishnan (Amount imposed under the compounding orders dated 5-1-2018 & 31-1-2018 – ₹ 83,300/- each)

Facts of the Case

In 2015-16, Shri Mahesh Ramakrishnan & Shri S. Ramakrishnan (being Indian residents and Directors of Indian Company M/s. M.S.R. Garments Private Limited) entered into an understanding with Mr. Ian Meirs and Mr James Sleater, acting collectively for M/s. Cad and Dandy Limited, a company incorporated in United Kingdom for sale of 66.66% in aggregate of the paid up equity capital of the Indian company to the UK company at an aggregate price of ₹ 1,18,72,800.

The sale consideration of ₹ 60,40,904/- was received by Shri Mahesh Ramakrishnan on December 16, 2015 in his bank account with HDFC Bank. Whereas the sale consideration of ₹ 60,39,563/- was received by Shri S. Ramakrishnan on December 16, 2015 in his bank account with ICICI Bank. However, the sale consideration was received by both individuals through a third party intermediary, vis. Transferwise and not through banking channel.

The transaction was reversed and the refund took place on November 22, 2017, subject to compounding.

Contravention:

The contravention sought to be compounded relates to the following:

- Receipt of remittance through non-banking channel: Paragraph 10(iv) of Schedule I to erstwhile Notification No. FEMA 20/2000-RB stated as follows - “(iv) The sale consideration in respect of shares or convertible debentures remitted into India through normal banking channels, shall be subjected to a KYC check by the remittance receiving AD bank at the time of receipt of funds. In case, the remittance receiving AD bank is different from the AD bank handling the transfer transaction, the KYC check shall be carried out by the remittance receiving bank and the KYC report shall be submitted by the customer to the AD bank for carrying out the transaction along with the Form FC-TRS.”

(Comments:

- *Though Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations have been replaced by revised regulations Para 2(1) of Schedule 1 to extant FEMA 20(R)/2017-RB dated 07/11/2017 corresponds to Paragraph 10(iv) of Schedule I to erstwhile FEMA 20/2000- RB dated May 3, 2000.*

- *One should bear in mind that only the following modes are permitted for receiving payment of consideration under Schedule 1: (a) inward remittance from abroad through banking channels; (b) debit to NRE/FCNR(B) / Escrow account. Accordingly, receiving payment through other modes such as deposit of foreign cheques transfer through online money transfer portals such as TransferWise, PayPal etc. are not permitted.)*

10. C.A. No. 741/2017 in the matter of M/s. Karadi Path Education Company Pvt. Ltd. (Amount imposed under the compounding order dated 10-1-2018 – ₹ 1,92,477/-)

Facts of the Case

Amongst other facts, the company converted 5432 CCPS to 7730 equity shares on 10-9-2013 at ₹ 1543.08 per share. However, the fair value of equity shares as on the date of allotment of CCPS (25-2.2013) was ₹ 1990.42. The shortfall was brought in by way of inward remittance as detailed below:

Sr. No	Date of Conversion	Amount of Shortfall (INR)	Date of receipt
1	10-9-2013	34,57,938.20	24-5-2017

The shortfall was brought in with delay of three years eight months and 14 days approximately.

Selected Contravention

The contravention sought to be compounded relates to the following:

- Conversion of compulsorily convertible preference shares to equity shares at a price less than the fair value: In terms of Paragraph 5 of Schedule I to erstwhile Notification No. FEMA 20/2000-RB the price of shares issued to persons resident outside India under this Schedule, shall not be less than the fair valuation of shares.

(Comments)

- *Though Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations have been replaced by revised regulations; Explanation to Regulation 11(1) to extant FEMA 20(R)/2017-RB dated 7-11-2017 corresponds to Paragraph 5 of Schedule I to erstwhile FEMA 20/2000-RB dated May 3, 2000.*
- *We have dealt with only one of the several contraventions committed by the company in this case. It needs to be borne in mind that the price at the time of conversion should not in any case be lower than the fair value worked out at the time of issuance of such instruments. If shares are converted at a price which is lower than their fair value as worked out at the time of issuance of such convertible instruments, it may amount to affording concessions to the foreign investor either at the expense of the resident shareholders or otherwise.)*

C. Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad

11. C.A. No. 4501/2017 in the matter of Tata Hitachi Construction Machinery Company Private Limited (Amount imposed under the compounding order dated 12-1-2018 – ₹ 1,14,12,800/-)

Facts of the Case

Tata Hitachi Construction Machinery Company Private Limited acquired 60% stake in M/s. Comoplesa Lebrero S.A., Spain, in 2008, for a consideration of Euro 3.60 million. The remaining 40% stake was acquired in 2011-12, making the overseas entity a Wholly Owned Subsidiary (WOS) of the applicant. The total investment of the applicant in the WOS was to

the extent of equity of Euro 7 million and loan of Euro 17.84 million (a total of INR ₹ 181.89 crore). After exhausting all options of revival of the WOS, the applicant liquidated the WOS with effect from March 31, 2015, with a write-off of the entire amount of investment, i.e., INR 181.89 crore.

Amongst other facts, the interest due on the loan (INR 5.49 crore) was not repatriated but written off.

Selected Contravention

The contravention sought to be compounded relates to the following:

- Non-repatriation of dues within 60 days and writing off the interest on loan upon liquidation: Regulation 15(ii) of Notification No.FEMA.120/2004-RB dated July 7, 2004 as amended from time to time states as follows - "An Indian Party, which has acquired foreign security in terms of the Regulations in Part I, shall – repatriate to India, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc., within 60 days of its falling due, or such further period as the Reserve Bank may permit".

(Comments: We have dealt with only one of the several contraventions committed by the company in this case. Although Regulation 15(ii) of Notification No.FEMA.120/2004-RB dated July 7, 2004 mentions dividend, royalty, technical fees, these receivables are only illustrative in nature. Accordingly, even export receivables may get covered under this regulation. Therefore, it needs to be borne in mind that the usual time period of 9 months as provided under FEMA 23(R)/2015-RB dated 12-1-2016 may not apply when receivable is due from the overseas JV/WOS and instead a shorter period of 60 days may be applicable.)

12. C.A. No. 4469/2017 in the matter of Halcyon Finance & Capital Advisors

Private Limited (Amount imposed under the compounding order dated 2-1-2018 – ₹ 2,31,58,756/-)

Facts of the Case

Halcyon Finance & Capital Advisors Private Limited (HFC) is a private limited company incorporated on February. In April 2010, HFC set up a wholly-owned subsidiary (WOS) in Singapore namely, Infrahealth Pte. Ltd. (hereinafter referred as 'WOS') and remitted USD 200,000 and USD 3,614,676 on July 13, 2010 & July 16, 2012 respectively to the overseas WOS towards acquisition of its equity shares. The overseas WOS raised USD 60 million (USD 50 million as term loan and USD 10 million as credit line) from JP Morgan Chase Bank, Singapore through convertible credit facility. In July 2010 the overseas WOS acquired the entire stake in M/s Integrated Health & Healthcare Services Private Limited (IHHS India now called as M/s Radiant Life Care Private Limited) from another non-resident entity viz. M/s Integrated Hospital & Healthcare Services, Mauritius for an amount of USD 44,382,975 (₹ 209,21,57,752/-) and subsequently during the period 2010-2016 further invested USD 18,061,528 ((₹ 92,85,65,229/-) in the equity of IHHS, India by way of remittances into India (total investment in SDS was USD 62,444,503 i.e. ₹ 302,07,22,981/- approximately). Thus, IHHS, India became a subsidiary of the overseas WOS and a step down subsidiary (SDS) of HFC.

RBI vide letter FE.CO.OID No.6789/19.58.025/2013-14 dated October 3, 2013 advised HFC to unwind either FDI or ODI leg of the structure. Accordingly, the FDI leg was unwound by transfer of the shares of IHHS, India held by the overseas WOS to HFC for a consideration of ₹ 426,00,36,447/- on November 16, 2016. The acquisition of IHHS, India by HFC was funded out of the funds raised through loans and non-convertible debentures from M/s. KKR India Financial Services Private Ltd. and its affiliates.

Selected Contravention

The contravention sought to be compounded relates to the following:

- Undertaking foreign direct investment (FDI) through the overseas direct investment (ODI) route: Regulation 6(2) (ii) of Notification No. FEMA. 120/2004-RB dated July 7, 2004 states that an Indian party may make direct investment in a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India provided that direct investment is made in an overseas JV or WOS engaged in a *bona fide* business activity. Whereas the acquisition of the Indian entity by the overseas WOS in 2010 resulted in an ODI-FDI structure thereby leading to contravention of the said FEMA Regulation.

(Comments: We have dealt with only one of the several contraventions committed by the company in this case. This was a case of round-tripping of funds whereby the overseas WOS was used to acquire stake in another Indian company. It cannot be comprehended that, when the funds invested in the overseas WOS were not (significantly) utilized for acquisition of another Indian entity and that such acquisition was largely funded by raising funds from a foreign bank, such case could qualify as fit for being branded as a case of round-tripping of funds.)

13. C.A. No. 4473/2017 in the matter of Hurix Systems Private Limited (Amount imposed under the compounding order dated 25-1-2018 – ₹ 2,75,596/-)

Facts of the Case

The applicant company was incorporated as Hurix Systems Pvt. Ltd. on May 22, 2000. In

October 2001, the applicant incorporated a wholly owned subsidiary (WOS) in the name Hurix Systems Inc in USA to engage in building, distributing and managing digital content across various IT platforms and to cater to the company's US customers.

Hurix USA did not gain much business and remained non-operational till many years till it was voluntarily liquidated in 2015. The Indian Party received a Dissolution Certificate stating the date of dissolution as 1-6-2015. Amongst other facts, no valuation certificate was produced to show the value of shares at the time of dissolution and the company wrote off its entire investment.

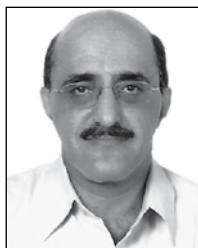
Selected Contravention

The contravention sought to be compounded relates to the following:

- Disinvestment without submission of a valuation certificate: According to Regulation 16(1)(iii) of Notification No FEMA 120-RB 2004 as amended from time to time, an Indian Party may disinvest any share or security held by him in a Joint Venture or Wholly Owned Subsidiary outside India provided that the share price is not less than the value certified by a Chartered Accountant /Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the Joint Venture or Wholly Owned Subsidiary.

(Comments: We have dealt with only one of the several contraventions committed by the company in this case. It needs to be borne in mind that conduct of valuation is required also in the case of liquidation since it would confirm the veracity of the aggregate liquidation proceeds to be received by the Indian Party upon liquidation.)

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In Focus – Accounting and Auditing

FINANCIAL LIABILITIES – RECOGNITION AND MEASUREMENT

Introduction

Borrowings together with share capital and retained earnings (collectively referred to as equity) represent the funding life line of corporates. Under Indian GAAP the accounting for the same was dictated more by the legal and contractual form of the instrument and not by its economic substance and consequently such liabilities were reflected at the amounts received and the payments towards interest on borrowings were recognised on a time proportion basis whereas the dividend payments were recognised as distribution once the approvals were received. This is also referred to as the historical cost accounting which does not provide economically useful decisions.

Over time, the sophistication of the funding avenues have increased significantly resulting in the introduction of many new types of complex and innovative financial instruments. Further, it was imperative to determine whether these financial instruments represents *liability or equity characteristics* to depict their economic substance rather than the legal/contractual form. Prior to the advent of Ind AS, there were *no comprehensive mandatory Accounting Standard(s)* which dealt with all the above referred matters and other related aspects. However, *the ICAI had issued the following three Accounting*

Standards which corresponded with the similar IFRS Standards at that point of time, which were never notified, though entities were encouraged to adopt the principles laid down therein to the extent they did not conflict with other notified Accounting Standards. Considering their non-mandatory nature hardly any users applied these standards.

- **AS-30** : *Financial Instruments – Recognition and Measurement*
- **AS-31** : *Financial Instruments – Presentation*
- **AS-32** : *Financial Instruments – Disclosures*

Whilst the above Standards were deliberated upon, the International Accounting Standards Board (IASB) itself changed the standards and consequently, the following corresponding Ind ASs were notified, which dealt with specific aspects pertaining to financial instruments.

Accounting Standard	Matters Dealt With
Ind-AS-32 – Financial Instruments: Presentation	Principles for depicting financial instruments as liabilities or equity*
Ind-AS-109 – Financial Instruments: Recognition and Measurement	Principles for financial reporting of financial assets and liabilities *

*In this article we will only deal with financial liabilities (excluding derivatives) and related matters as dealt with in both the Standards.

Overview of Ind AS-32 in the context of financial liabilities

One of the objectives of Ind AS-32 is to establish principles for *presenting and classifying financial instruments as liabilities or equity from an issuer's perspective, together with the classification of related interest, dividend, gains and losses*. The accounting classification and presentation of financial instruments as liability or equity can have a significant impact on the financial performance of entities compared with the past. In this context, for instruments which are now required to be classified as a liability instead of equity, the return payable on them in the form of dividend would now be required to be shown as interest instead of as an appropriation / distribution of profit along with the corresponding dividend distribution tax in respect thereof. This will also have an impact on the on certain key performance indicators such as debt equity ratio and EPS. Whilst in most of the cases, the financial instruments would be either in the nature of a financial liability or equity, in certain cases, the instruments would reflect features of both liability and equity, which are commonly referred to as *compound financial instruments*. Ind AS-32 also deals with the accounting of such instruments from an issuer's perspective.

The principles of Ind AS-32 complement the principles for recognition and measurement of financial liabilities as laid down in Ind AS-109 which are discussed later.

Accordingly, our analysis of Ind AS-32 is broadly structured on the following lines for the purposes of further study and discussion.

- **Meaning of Financial Liability and Equity**
- **Financial Liability versus Equity Classification**

- **Compound Financial Instruments**
- **Interest, Dividend, Losses and Gains**
- **Practical Considerations**

Let us now proceed to dig a little deeper into each of the above aspects.

Meaning of Financial Liability and Equity

Before proceeding to examine the classification and presentation of financial instruments, it is important for us to understand how these terms are defined.

Financial Liability

Financial Liability is defined as any liability that is:

- a) *A contractual obligation:*
 - (i) to deliver cash or another financial asset to another entity or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity.
- b) A contract that will or may be settled in the *entity's own equity instruments* and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

The following are certain issues which are relevant in the context of contracts which may be settled by an entity's own equity instruments:

- a) **rights, options or warrants** to acquire a *fixed number of the entity's own equity instruments* for a *fixed amount of any currency* are **equity instruments** (as defined below) if the entity offers the rights, options or warrants on a *pro rata* basis to all of its existing owners of the same class of its own non-derivative equity instruments.
- b) **equity conversion option embedded in a convertible bond denominated in foreign currency (commonly referred to as FCCBs) to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. (A further discussion on the accounting treatment of FCCBs in the Indian context follows later).**

However, for these purposes, entity's own equity instruments do not include:

- **Puttable financial instruments** (discussed later) that are classified as equity instruments in accordance with the exception criteria discussed later,
- Instruments that impose on the entity an obligation to deliver to another party a *pro rata* share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with the exception criteria discussed later, or
- Instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

Puttable Instruments

A puttable instrument is defined as a financial instrument that gives the *holder the right to put the instrument back to the issuer* for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

Accordingly, based on the general principles as discussed above, a puttable instrument exhibits the *basic features of a financial liability*, even if the *legal form thereon gives the holder a right to a residual interest in the assets of the issue, in the context of equity instruments as discussed below.*

Based on the above criteria, entities such as open ended mutual funds, venture capital fund and similar entities will have no equity instruments at all and consequently any distributions by such entities would have to be reflected as a charge rather than as a distribution to the profit and loss account.

*To deal with the above concerns, the Ind AS contains certain **exceptions** that are applicable to such instruments for them to be considered as equity.*

Equity Instrument

Equity Instrument is defined as any contract that evidences *residual interest* in the assets of an entity after deducting all of its liabilities.

Accordingly, a financial instrument will be treated as equity if it meets both the following criteria:

- a) There is no obligation (direct or indirect) to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions potentially unfavourable to the issuer; and
- b) The issuer will exchange fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Financial Liability Versus Equity Classification

Let us now proceed to examine the key principles dealing with the liability versus equity classification of financial instruments based on the definitions of the said terms as discussed above, which can also be referred to as the **general classification criteria.**

Further, there are also certain **exception rules** which allow certain **puttable instruments** to be classified as **equity**. These and other related aspects are examined in the following sections.

Key Principles / General Classification Criteria

The issuer of a financial instrument has to classify an instrument or its component, on initial recognition, into financial liability or equity based on substance of the contractual arrangement, and the definitions of financial liability or equity instrument, discussed earlier. Further, the *entity's intentions or factors that are not part of the contractual arrangements are not to be considered*. Accordingly, the focus is on the legal and contractual rights and obligations arising from the terms of an instrument. Any other aspects such as probability of outflow and expectations and economic considerations for the holder are not relevant.

Restrictions on the entity's ability to satisfy contractual obligation do not prevent its classification as a financial liability. Such restrictions could be regulatory approval for payment, lack of access to required funds etc. Similarly, uncertain future events (contingent settlement provisions) beyond the control of issuer or holder of the instrument also do not prevent the financial liability classification. For classification as 'equity', what is required is 'unconditional' right to avoid delivery of cash/ financial asset.

Obligation may be contingent upon occurrence or non-occurrence of uncertain future events that are beyond the control of both the issuer and holder e.g. change in stock market index, taxation requirements, debt-equity ratio. As long as the obligation exists, instrument is a financial liability unless contingent settlement provisions which are not genuine (i.e. occurrence is extremely rare, highly abnormal and very unlikely to occur) or obligation to deliver cash etc. is only in the event of liquidation of the issuer.

Puttable Instruments as Equity

As discussed earlier, a puttable instrument gives the holder right to demand redemption for cash or another financial asset and therefore has features of a financial liability.

However, as an exception to this rule, some puttable instruments that satisfy certain criteria prescribed below, are required to be classified and presented as equity.

- a) The holder is entitled to a *pro rata* share in the net assets of the entity upon liquidation.
- b) The instrument is subordinate to all other class of instruments and all instruments in that class have identical features.
- c) Total expected cash flows over the life of the instrument are based on the profit or loss or changes in net assets over the life of the instrument.
- d) Entity has no other instrument that has cash flows stated in (c) above and which can restrict or fix the return on puttable instruments.

There are certain puttable instruments which impose an obligation to deliver to another party a *pro rata* share of the net assets of the entity only on liquidation which are also classified as equity such as when the liquidation is certain or is uncertain but at the option of the holder.

The above-mentioned exception is not available for instruments held by non-controlling interests which have to be classified and presented as a financial liability in the consolidated financial statements.

An entity shall **reclassify an equity instrument as a financial liability** from the date when the instrument ceases to have all the features or meet the conditions specified earlier. In such cases, the financial liability shall be measured at the instrument's fair value at the date

of reclassification. Further, the entity shall recognise in equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

Further, an entity shall **reclassify a financial liability as equity** from the date when the instrument has all the features and meets the conditions specified earlier. In such cases, the equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

Compound Financial Instruments

As discussed earlier, some of the financial instruments contain features which represent partly a liability and partly an equity, from an issuer's perspective. Such instruments are referred to as compound financial instruments. The following are some of the common examples of compound instruments:

- Bond convertible into a fixed number of equity instruments whereby the issuer's obligation to pay interest and potentially to redeem the bond in cash is a financial liability and the holders right to call for fixed number of equity shares of the issuer is a financial liability.
- Mandatorily redeemable preference shares whereby the *dividends are paid at the option of the issuer*, which effectively comprises of the issuers obligation to redeem the shares in cash which represents a financial liability and the holders right to receive dividends, if declared, which is an equity instrument.

Accounting Treatment

The Ind AS deals with the accounting of compound financial instruments from the issuers perspective and requires him to evaluate whether a financial instrument contains both liability and equity components, both of which

need to be recognised initially. This method is commonly referred to as *split accounting*.

The accounting principles are broadly summarised hereunder:

- a) The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, or equity instruments
- b) Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders.
- c) Ind AS 109 deals with the measurement of financial assets and financial liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component.
- d) The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component.
- e) The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument

as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

- f) The issuer of such instruments are required to present the liability component and the equity component separately in the balance sheet, as follows:
- (i) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. *On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.*
 - (ii) The equity instrument is an embedded option to convert the liability into equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. *This option has value on initial recognition even when it is "out of the money".*
- g) On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.
- h) When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges

are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and equity components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued. In such cases, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

- (i) the amount of gain or loss relating to the liability component is recognised in profit or loss; and
- (ii) the amount of consideration relating to the equity component is recognised in equity.

Interest, Dividends, Losses and Gains

The broad accounting principles for all costs and charges related to financial liabilities and equity can be broadly analysed under the following heads.

Dividend and Interest Payments

The accounting principles in respect thereof are broadly summarised hereunder:

- a) Distributions to equity shareholders should be debited directly to equity, net of any related income tax benefit.
- b) Dividend payments on shares wholly recognised as a financial liability are recognised as an interest expense on the bond/debt.
- c) Dividend payments which are at the discretion of the issuer, even in case of mandatorily redeemable shares, will be treated like compound instruments

as discussed earlier. In such cases, the liability component being PV of the redemption amount and the balance equity will be treated as dividend payment on the equity component.

Transaction Costs (Share Issue Expenses)

An entity typically incurs several costs in issuing equity instruments, both regulatory and non-regulatory. These are cost which are directly attributable to the equity transactions and which could not otherwise have been avoided. As per the Ind AS, any such costs, net of tax, would have to be directly recognised in equity. Accordingly, the present practice of adjusting such expenses against Securities Premium account in terms of the Companies Act would continue. The Ind AS also provides that any transaction costs that relate *jointly to more than one transaction* e.g. costs of concurrent offering of some shares and a listing of other shares are to be allocated on a rational basis, since *cost of listing shares already issued would not be regarded as transaction costs. This would be relevant in case of Offer of Existing Shares to the general public and their listing.*

Practical considerations

After having examined the broad principles for classification and recognition of financial liabilities and equity it would be worthwhile to evaluate the peculiar and particular issues that arise in the context of certain instruments which are commonly issued by Indian companies.

Preference Shares

Some of the factors which need to be kept in mind whilst dealing with preference shares are discussed hereunder:

- Equity and financial liability classification of preference shares depends upon the terms and conditions, principal repayment or dividend pay-outs. The key question is do the rights attached to preference shares exhibit fundamental

characteristics of a financial liability i.e. unavoidable obligation to deliver cash or another financial assets. Some of these may result into 'Compound Instruments, which may need to be accounted for accordingly.

- Preference shares which are mandatorily redeemable for a fixed or determinable amount at a future date are classified as financial liabilities. However, if the redemption is at the option of the issuer then it is classified as equity. Further, some of the mandatorily redeemable preference shares may have economic features of compound instrument e.g. dividend pay-out may be at the discretion of the issuer. In such cases, the instrument has two components
 - (a) The financial liability is measured at the PV of the redemption amount and the unwinding of discount is treated as Interest Expense in the profit and loss account
 - (b) Dividends paid, if any, are treated as distribution out of profit and loss to equity holders.
- Non-redeemable preference shares are evaluated considering other rights attached to them e.g. dividend distributions. If dividend pay-outs are mandatory, whether cumulative or non-cumulative, these are treated as financial liabilities rather than equity.

Foreign Currency Convertible Bonds (FCCBs)

Many Indian companies have used FCCBs to raise finance for their operations. The current Indian GAAP does not contain any specific accounting guidance for such instruments and consequently the following practices are in vogue:

- a) They are recognised at face value and interest is recognised at the stated coupon rate, if any.

- b) With regard to the accounting for the premium, differing practices as under are followed:
- (i) The premium payable is amortised over the period of the FCCBs.
 - (ii) It is treated as a contingent liability.
 - (iii) The same was charged to the Securities Premium Account as permitted under the Companies Act, 1956. However, this treatment is not permissible under the Companies Act, 2013.

Under Ind AS -32, FCCBs are in the nature of *compound financial instruments* if the equity conversion option embedded therein requires the entity to *issue equity shares, the exercise price is fixed in any currency*. In such cases, the split accounting method for compound financial instruments as discussed earlier needs to be followed.

However, there is a **specific carve out under Ind AS** vis-a vis the corresponding IFRS standard, wherein the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is *an equity instrument even if the exercise price is fixed in any currency*.

Accordingly, though fresh issuances of FCCBs have virtually stopped, the terms of the existing FCCBs issued by corporates would need to be evaluated on the date of transition to Ind AS to ascertain whether and to what extent they meet the equity or compound financial instruments criteria.

Perpetual Bonds / Instruments

In line with global trends many Indian companies have also in the recent past been issuing perpetual bonds, the typical terms of which are as under:

- a) The bonds are unsecured, non-convertible and listed on one or more stock exchanges.
- b) They are perpetual and do not have any maturity date or an event of default whereby the bond holder can require the issuer to repay / redeem / recall the bond.
- c) The issuer, at its sole discretion can call the bonds at the end of the specified period or on early occurrence of one or more specific events.
- d) The bonds are junior to all the unsubordinated creditors and senior only to the equity share capital of the issuer.
- e) Subject to deferral of distribution, the bonds carry interest at the stated coupon rate. However, if the issuer decides not to repay / recall the bonds at the end of the specified period, the interest rates on the bonds will increase by a specified rate.
- f) The issuer has a right to defer the interest / distribution. However in most cases, the same cannot be deferred if the issuer declares dividend on its equity shares.
- g) The unpaid interest is cumulative and is payable generally in the following circumstances:
 - (i) The issuer declares/pays dividend on its equity shares.
 - (ii) The issuer redeems the bonds
 - (iii) The issuer goes in liquidation.

Keeping the above in mind, the issuers face the following major challenges with regard to the accounting treatment of such bonds:

- a) **Whether these bonds need to be classified as a liability or equity:** In this context what needs to be considered is

whether the holder has a contractual right to receive cash or other financial assets for which he can enforce his rights in a Court. Only in such cases the instrument can be classified as a liability.

- b) **Whether the interest distribution / accrual needs to be treated as interest chargeable to profit or loss or as distribution of profit:** If the instrument provides the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future, the holder and issuer of the instrument have a financial asset and a financial liability, respectively. *However, if the interest payment is at the discretion of the issuer or can be deferred at the discretion of the issuer, such perpetual instruments can be classified as equity.*

Companies need to be very clear about the terms of issue of such bonds since it would have an impact on the profitability coupled with EPS, leverage and gearing ratios. The preference would always veer towards instruments which have equity features to reflect favourable trends in respect of the above considerations.

After having reasonably set to rest what constitutes a financial liability or an equity it is now necessary for us to understand the recognition, classification and measurement requirements with respect to financial liabilities under Ind AS 109.

Overview of Ind AS-109 in the context of financial liabilities

As discussed earlier, Ind AS-109 deals with various aspects of financial instruments, including derivatives and it supplements the requirements of Ind AS-32 in so far as it relates to accounting for financial liabilities as

determined in accordance with the criteria laid down in the said Ind AS.

Accordingly, our analysis of Ind AS-109 is broadly structured on the following lines for the purposes of further study and discussion.

- **Recognition and Derecognition of Financial Liabilities**
- **Classification of Financial Liabilities**
- **Measurement of Financial Liabilities**

Let us now proceed to dig a little deeper into each of the above aspects.

Recognition and Derecognition of financial liabilities

Once an entity has concluded on the classification of a financial instrument as a financial liability in accordance with the criteria discussed above, it needs to ascertain the recognition and derecognition criteria for the same, which are briefly discussed below.

Initial Recognition of Financial Liabilities

An entity shall recognize a Financial Liability when and only when the entity becomes a party to the *contractual provisions* of the instrument. Accordingly, unconditional payables, are recognised as a liability only when the entity becomes a party to the contract, which may be written or otherwise, as a consequence of which it has a legal obligation to pay cash.

The Ind As has provided a practical exception to this general principle in respect of *firm commitments to purchase goods or services*. Accordingly, any such liabilities are generally not recognised until one of the parties has performed under the agreement, unless a forward contract is entered into.

Derecognition of Financial Liabilities

The requirements for derecognition of financial liabilities focus more on the legal obligations rather than on the economic substance and

hence it is a reversal of the general proposition under Ind AS. Accordingly, the broad principles for derecognition of financial liabilities are discussed hereunder:

- a) Financial Liabilities can be derecognized only when liability is **extinguished** i.e. when the obligation under the contract is discharged or cancelled or expires. Legal release from liability by the creditor to the debtor is a must, to be eligible for derecognition. This normally happens when the debtor pays to a third party and intimates the creditor who need to legally release the debtor.
- b) If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term. Therefore, there is no concept like 'Treasury Shares' for Financial Liabilities.
- c) Difference between carrying amount of extinguished financial liability and the consideration paid is recognised as gain or loss in the profit and loss account.
- d) Substantial changes to the terms and conditions between borrower and lender (whether or not attributable to the financial difficulty of the debtor) has to be accounted as 'extinguishment' of the original liability and recognition of new liability.
- e) In the context of the above, the Ind AS specifically provides that if the discounted (at original EIR) present value of the cash flows under the new terms is at least 10% different from the remaining discounted (at original EIR) cash flows of the original financial liability, then it is deemed to be substantial change in terms. *This would be relevant in the context*

of various restructuring proposals under the Insolvency Code which are under negotiation.

- f) A modification of the terms of a liability such as reset of the interest rates on a periodical basis are not considered as substantial changes and accordingly the differences in the PV of the cash flows based on the modified an original flows should be adjusted to the profit and loss account.

Classification of Financial Liabilities

The classification of financial liabilities is relevant from the point of view of its subsequent measurement. Whilst the Ind AS has provided for classification of all financial liabilities under the following two classes, in practice the **second alternative is followed only if the entity has specifically designated a financial liability as such or it satisfies certain other criteria as discussed below.**

- **Financial Liabilities for subsequent measurement at amortised cost using the EIR (discussed later), which is the default preferred alternative.**
- **Financial Liabilities at Fair Value through Profit and Loss (FVTPL)**

Further, the Ind AS also lays down the following exceptions to the amortised cost model:

- a) **Financial liabilities relating to transfer cases** where derecognition criteria are not met or when the continuing involvement approach applies. In such cases the financial liability shall be recorded at the consideration received.
- b) **Financial guarantee contracts** which have to be subsequently measured at higher of the following amounts i.e., impairment loss amount determined or amount initially recognised less cumulative amortisation of fee/commission received per Ind AS-18 on Revenue.

- c) **Commitment to provide loan below market interest rate which** have to be subsequently measured at higher of the following amounts i.e., impairment loss amount determined or amount initially recognised less cumulative amortisation of fee/commission received per Ind AS 18 on Revenue.
- d) **Contingent Consideration recognised by an acquirer under Ind AS-103 Business Combination** which shall be subsequently measured at fair value with gains/losses recognised in the profit and loss account.

It is imperative for an entity to determine the correct classification since Ind AS-109 does **not permit reclassification of financial liabilities.**

Financial Liabilities at FVTPL

The Ind AS provides specific criteria or circumstances under which financial liabilities can be measured at FVTP, which are as under:

- **They are managed on Fair Value Basis, or**
- **Those which are designated as such at initial recognition, and**
- **They are Held for Trading (HFT)**

The requirements laid down under each of these are discussed as under.

Management or Initial Designation on a Fair Value Basis

An entity may, at initial recognition, irrevocably designate a financial liability as measured at FVTPL, when doing so results in more relevant information, because either:

- a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases e.g., an entity

which has insurance contracts whose measurements incorporates current information and the corresponding financial asset in respect thereof are measured at amortised cost or FVTOCI, or

- b) A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy and information about the group is provided internally on that basis to the entity’s key management personnel or the entity’s board of directors and chief executive officer.

Accordingly, the focus is on how an entity manages and evaluates its performance rather than on the nature of the financial instrument. The documentation strategy could be at a group level and in line with its risk management strategy but need not be very extensive. In most of the cases, *especially on transition, the entity’s existing documentation as approved by its key management personnel should be sufficient and need not be amended / recreated.*

Financial Liabilities in the nature of HFT

Following financial liabilities would normally be treated as HFT:

- a) Derivative liabilities other than those accounted as hedging instruments.
- b) Obligations under ‘Short Sale’ transactions.
- c) Financial liabilities raised with the intention to repurchase or buy back in the near term.
- d) Financial liabilities where there is evidence of recent pattern of short term profit-taking.

Measurement of Financial Liabilities

Whilst the initial measurement of financial liabilities takes into consideration the fair value,

which is the price at which an orderly transaction would take place between market participants under market conditions that exist at the measurement date, the subsequent measurement would need to be at amortised cost for items classified as other than at FVTPL. **For determining the fair value, the principles enunciated in Ind AS-113 – Fair Value Measurement need to be kept in mind, the discussion of which is beyond the scope of this article.** Let us now briefly proceed to examine the principles underlying the initial and subsequent measurement of financial liabilities.

Initial Measurement of Financial Liabilities

The Ind AS provides that all financial liabilities shall be initially measured at fair value less any transaction costs (discussed later) directly attributable to the issue of the liability which is not at FVTPL. Accordingly, in case of FVTPL all transaction costs need to be charged to profit and loss. *Whilst in most cases the transaction price would be equal to the fair value, in case there is a difference e.g., in case of group company transactions, the difference should be recognised in the profit and loss account (commonly referred to as day one gain / loss).*

Subsequent Measurement of Financial Liabilities

These can be further analysed under the following broad headings:

Financial Liabilities under FVTPL and HFT

Financial liabilities under FVTPL and HFT continue to be subsequently measured at fair value and changes thereon are recognised in the profit and loss account. However, the following principles apply for calculation of the **gain or loss attributable to changes in credit risk**:

- In respect of financial liabilities designated as **HFT**, any such gains or losses are recognised in the profit and loss account.

- In respect of financial liabilities designated as **FVTPL**, changes in fair value attributable to the entity's own credit risk need to be recognised in **OCI**. **Such credit risk arises when one party to a financial instrument will cause a financial loss to the other party by failing to discharge its obligations which may not always be due to creditworthiness of an issuer but due to other factors such as collaterals. In the Indian context, since most financial liabilities are classified on an amortised cost basis, such calculations would not be warranted except for certain derivative or short sale transactions undertaken by banks and other financial service entities.**

Financial Liabilities on Amortised Cost Basis

As discussed earlier, a majority of the financial liabilities would fall under the amortised cost method for the purposes of subsequent measurement. Ind AS-109 defines amortised cost as the amount at which the financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the **effective interest method** of any difference between that initial amount and the maturity amount.

Based on the above definition, there are two components, as under, for determining the amortised cost of a financial liability:

- **Effective Interest Method**
- **Transaction Costs and Fees**

Let us now briefly understand each of these.

Effective Interest Method:

Effective Interest Method refers to a method of calculating the 'Amortized cost' of a financial liability and of allocating the interest expense over the relevant period based on Effective Interest Rate (EIR).

EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the Financial Instrument to amortised cost of the financial liability. When calculating the EIR, the entity should estimate the cash flows expected over the life of the instrument considering the contractual terms. *The expected life of a financial instrument can be greater or shorter than its contractual life.* For working out these cash flows, the calculation should include the following:

- a) All fees received which are integral part of the EIR
- b) Transaction costs incurred at the time of acquisition issue of the financial liability.
- c) Any other premiums and discounts.

Transaction Costs and Fees

As can be seen above ascertaining and identifying the transaction costs and fees is one of the important factors in determining the EIR and hence it is important to ascertain as to what fees and costs need to be *scoped in* and *scoped out* for the purposes of calculating the EIR.

The Ind AS defines transaction costs as those *incremental costs* that are *directly attributable* to the issue of a Financial Liability and should be included as part of interest expense and allocated using EIR method. For this purpose, an incremental cost is the one that would not have been incurred if the entity had not issued a financial liability. This is very important to bear in mind in deciding which internal costs will be eligible for amortisation and which ones are not.

Transaction costs generally include fees/commissions paid to external agencies and commissions/incentives paid to internal sales staff, Government levies, transfer charges etc. However, internal administrative costs/financing costs, debt premium/discount are not to be included. Further, syndication fees, servicing fees and commitment fees are also generally not considered.

Applicability to Financial Liabilities where Interest Rates are floating:

Ind AS-109 provides that in respect of floating rate financial liabilities, periodic re-estimation of the cash flows to reflect the movement in the interest rates alters the EIR. However, the Ind AS provides that if the floating rate financial liability is initially recognised at the principal amount payable on maturity, re-estimation of the future interest payments would normally not have a significant impact on the carrying amount of the liability. However, the Ind AS further provides that if there are any transaction costs or premium / discount associated with the floating rate instrument, the entity would need to amortise the same over the life of the instrument, especially if the impact is material.

Conclusion

The above discussion is just the tip of the iceberg on a topic which can turn out to be quite complex depending upon the structuring and terms of the instruments which would need to be harnessed with commercial, business, regulatory and legal and financial reporting considerations before the appropriate accounting can be accomplished.

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Character has to be established through a thousand stumbles.

— Swami Vivekananda



Kishor Vanjara, Tax Consultant

Tax Articles for Your Reference

Articles published in Taxman, The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant Journal (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Sales Tax Review (STR), Times of India and Economic Times for the period February, 2018 To March, 2018 has been arranged and indexed topic-wise.

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Rahul Sarada, *Advocate*

Best of the Rest

1. Power of Legislature – Retrospective amendment – Whether can set at naught any judgment between parties and overturn it?

In the year 1985, amendments were brought out to Karnataka Pawn Brokers Act, 1961 (P.B. Act) and the Karnataka Money Lenders Act, 1961 (M.L. Act). Sections 7-A & 7-B were introduced in the M.L. Act and corresponding Sections 4-A & 4-B were introduced in the P.B. Act. These amendments provided that the persons desirous of obtaining a licence had to deposit a security and the rate of security was fixed slab-wise in relation to the extent of business carried on by the licensee. These amendments were challenged by a large number of pawn brokers and money lenders *inter alia* on the ground that there is no provision for payment of interest on the security amount. While a Division Bench of the Karnataka High Court in *Manakchand Motilal vs. State of Karnataka I.L.R. 1991 KAR 1928* upheld the validity of Sections 7-A & 7-B of the M.L. Act and Sections 4-A & 4-B of the P.B. Act, the Division Bench held that the money lenders/pawn brokers were entitled to interest on the security deposits at the prevailing rate of interest payable by the scheduled banks on a fixed deposit for a period of one year and the State Government was also directed to make proper rules in this behalf. No appeal

was filed by the State of Karnataka against this judgment. The State framed certain rules pursuant to the directions of the Division Bench of the Karnataka High Court which were also challenged by the money lenders/pawn brokers. The Karnataka High Court approved some portions of the Rules but, at the same time, directed that the Rules be reframed in compliance with the earlier judgment.

Thereafter, the State of Karnataka enacted the Karnataka Money Lenders (Amendment) Act, 1998 and a similar amendment was also made to the P.B. Act in the year 1998 to provide that the security deposit shall not carry any interest and the amendments were deemed to be inserted from 31st May, 1985.

Upon challenge to the amendments, the Supreme Court held that the Legislature had the power to enact validating laws including the power to amend laws with retrospective effect. However, this could be done to remove causes of invalidity. When such a law is passed the Legislature basically corrects the errors which have been pointed out in a judicial pronouncement. Resultantly, it amends the law, by removing the mistakes committed in the earlier legislation, the effect of which is to remove the basis and foundation of the judgment. If this was done, the same did not amount to statutory overruling. Further held

that the Legislature could not set at naught the judgments which had been pronounced by amending the law not for the purpose of making corrections or removing anomalies but to bring in new provisions which did not exist earlier. The Legislature may have the power to remove the basis or foundation of the judicial pronouncement but the Legislature could not overturn or set aside the judgment, that too retrospectively by introducing a new provision. The legislature was not bound by the mandamus issued by the Court. A judicial pronouncement would always be binding unless the very fundamentals on which it is based are altered and the decision could not have been given in the altered circumstances. The Legislature could not, by way of introducing an amendment, overturn a judicial pronouncement and declare it to be wrong or a nullity. What the Legislature could do was to amend the provisions of the statute to remove the basis of the judgment.

Applying these principles to the present case, it was apparent that when the decision was rendered by the Karnataka High Court directing payment of interest on the security deposit, there was no provision providing for payment of interest or prohibiting payment of interest. The Court had observed that even if such a provision prohibiting payment of interest had been there in the statute such provision would be illegal. Therefore, there was no error pointed out by the Court which could have been corrected by the State Legislature. As pointed out above, the State, first tried to implement the judgment by framing rules providing for payment of interest. Later, it incorporated the contentious provisions prohibiting payment of interest. These amendments did not in any way alter the basis of the judgment. Therefore, the State, in so far as it has made the amended provisions retrospective, has attempted to nullify the writ of mandamus issued by the Court in favour of the respondents. This mandamus could not have been set at naught

by making the provisions retrospective. This would be a direct breach of the doctrine of separation of powers.

State of Karnataka vs. Karnataka Pawn Brokers Assn. [2018] 91 taxmann.com 228 (SC)

2. Insolvency & Bankruptcy Code – Maintainability of proceedings under the Code when winding up petition is admitted in High Court

The issue before the Court was whether the Company Court has any jurisdiction to stay the proceedings filed by a Corporate Debtor before NCLT even though a previously instituted company petition by a creditor had been admitted but where a provisional liquidator has not been appointed.

Held, IBC has been enacted to revive the Corporate Debtor by declaring a Moratorium of various proceedings and appointing an Interim Resolution Professional (IRP) to manage the affairs of the Corporate Debtor. Similarly, the IBC also contains a non-obstante provision to the effect of overriding the provisions of any other law in force except as excluded expressly. There is in fact no inconsistency between the provisions of IBC and Companies Act and in the event of any inconsistency, the provisions of IBC will prevail in view of Section 238 of IBC. Admission of the winding up petition by the jurisdictional High Court would not mean that NCLT either loses jurisdiction or cannot exercise jurisdiction in case of a petition which is filed by another creditor (financial, operational or the company itself under section 10 of IBC). The Legislature is deemed to be aware of the provisions of an existing law, i.e., the Companies Act, whilst enacting the provisions of IBC. If the Legislature intended, that those winding up petitions, of which the jurisdictional High Court remain seized, would have primacy over NCLT proceedings which may be filed in respect of the same company by another creditor, the legislature would have

said so, either in IBC or in the transfer rules Notification.

Further held that the fact that post notice winding up petitions continue to be governed by the Companies Act, 1956 only means - that to those proceedings it will be the Companies Act, 1956 which will apply. It does not, mean that if, in a post-notice winding up petition a new proceeding is filed under IBC, and where orders are passed by NCLT, including under Section 14 of IBC, the consequences provided for under IBC will not apply to post notice proceeding, whatever their stage may be. In fact, if petitioner's arguments were to be accepted, it would mean that there is no right available for any person covered by Section 6 of IBC to file a proceeding under IBC, in respect of a Company, against whom a winding up petition is retained in the High Court. Such an interpretation is not supported by the language of IBC. The mere fact that post notice winding up proceedings are to be "dealt with" in accordance with the provisions of the Companies Act, 1956 does not bar the applicability of the provisions of IBC in general to proceedings validly instituted under IBC, or does it mean that such proceeding can be suspended.

Jotun India Private Limited vs. PSL Limited
2018 (1) Bom. CR 524

3. Companies Act, 2013 – Board meetings – Whether directors can attend through video conferencing

A director of a company moved an application before the NCLT seeking facility of attending the board meetings through video-conferencing which was allowed by the NCLT. The appellants were aggrieved as they had apprehension that when the original petitioner participates in the meetings through video-conferencing, it would not be possible to ensure that nobody else was present from where the original petitioner would be participating.

On appeal before the NCLAT, held that Section 173(2) gives right to a director to participate in the meeting through video-conferencing or other audio-visual means and the Central Government has notified Rules to enforce this right and it would be in the interest of the companies to comply with the provisions in public interest. The NCLT took note of the fact that the company in this matter had all the necessary infrastructure available and came to the conclusion that the provisions of Section 173(2) of the 2013 Act are mandatory. Therefore, the NCLT was justified in granting permission to the director to attend the board meeting through video-conferencing and the order could not be interfered with.

Achintya Kumar Barua alias Manju Baruah vs. Ranjit Barthkur [2018] 91 taxmann.com 123 (NCLAT)

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45th Sir Jamshedji Kanga and Dr. Y. P. Trivedi National Tax Moot Court Competition

“45th Sir Jamshedji Kanga and Dr. Y. P. Trivedi National Tax Moot Court Competition” was held on 6th and 7th April, 2018, jointly with Government Law College, Mumbai and Rotary Club of Bombay. The said Moot was organised by the Students Committee of The Chamber of Tax Consultants under the Chairmanship of Mr. Sanjeev Lalan and Vice-Chairmanship of Mrs. Niyati Mankad.

We are grateful to Dr. Y. P. Trivedi, Past President for whole hearted support and guidance in holding the above competition. We are also thankful to Rotary Club of Bombay, and Government Law College for joining us in holding the Moot Court Competition.

The issues for the Moot Court Competition was drafted jointly by Mrs. Isha Sekhri and Mr. Vipul Joshi. The objective of the said Moot issues was to give an opportunity to the teams to prepare and argue on a case involving Income Tax Implications on Bitcoin related transactions before eminent Advocates, Chartered Accountants, Hon. Members of the ITAT and the Judges of the Hon’ble Bombay High Court.

The preliminary, quarter final and semi final rounds of the Competition were held at ITAT court rooms and the final round was held at Walchand Hirachand Hall, IMC. Twenty Law Schools/Colleges/Universities from various parts of the country participated in the Competition. The list of the Participating Law Schools/Colleges/Universities are as follows:

1. ICAI University, Dehradun
2. Symbiosis Law School, Pune
3. University Law College, Bengaluru
4. NMIMS Kirit P. Mehta School of Law, Mumbai
5. University of Five Year Law College, University of Rajasthan, Jaipur
6. Presidency University, Bengaluru
7. Amity Law School, Noida
8. University of Mumbai Law Academy, Mumbai
9. Government Law College, Mumbai
10. SASTRA University, Thanjavur
11. NUALS, Kochi

12. Jitendra Chauhan College of Law, Mumbai
13. NLSIU, Bengaluru
14. GNLU, Gandhinagar
15. NLIU, Bhopal
16. Campus Law Centre, Delhi
17. Maharashtra National Law University, Nagpur
18. G. J. Advani College of Law, Mumbai
19. MKES College of Law, Mumbai
20. University Institute of Legal Studies, Punjab University, Chandigarh

The preliminary round and quarter final round of the competition was judged by the professional Members of The Chamber of Tax Consultants and semi final round of the competition was judged by the Hon'ble ITAT Members i.e. Hon'ble Mr. R. C. Sharma, Hon'ble Mr. B. R. Baskaran, Hon'ble Mr. Mahavir Singh and Hon'ble Mr. Pawan Singh. The final round of the competition was judged by Hon'ble Justice Mr. K. R. Shriram of the Hon'ble Bombay High Court. We are thankful to all the professionals, ITAT Members and the Hon'ble Judge of Bombay High Court for sparing their valuable time for judging the competition.

We are thankful to Hon. Shri G. D. Agarwal, President ITAT, Mumbai for providing the court rooms for holding preliminary, quarter and semi final rounds. We are also thankful to Hon. Shri G. S. Pannu, Accountant Member ITAT for whole-hearted support and guidance in holding the above competition. We are also thankful to ITAT Bar Association for allowing us to make use of the ITAT Bar Library during the course of Competition.

The winner of the Competition was SASTRA University, Thanjavur and the Runner up was Symbiosis Law School, Pune. The Award for the best speaker of the Competition was won by Ms. Anushka Mehta, student of the Government Law College, Mumbai. The winners were felicitated by offering Trophy, Cash prize and Certificates at the hands of Dr. Y. P. Trivedi, Past President and Mr. Ajay R Singh, President. All the participants were felicitated by giving certificates of participation.

The Competition was attended by the Students, Managing Council Members and Past Presidents and Members of the Chamber. All the participants have been offered complimentary Student's Membership of The Chamber.

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Notice of Election

To

The Members,
The Chamber of Tax Consultants,
Mumbai

The election of the President and fourteen Members of the Managing Council for the ensuing year 2018-19 shall take place on **Thursday, May 31st, 2018** at the **Office of The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020.**

Nominations in the prescribed form should be filed so as to reach the office of the CTC not later than **6 p.m. on Friday, May 18th, 2018.** The nomination forms shall be available at the CTC office from **Friday, May 4th, 2018.**

**FOR AND ON BEHALF OF THE MANAGING COUNCIL OF
The Chamber of Tax Consultants**

Sd/-

Sd/-

KETAN L. VAJANI / NISHTHA PANDYA

Hon. Jt. Secretaries

Place : Mumbai

Dated : 13th April, 2018

Office : 3, Rewa Chambers, 31, New Marine Lines, Mumbai – 400 020.

Notes:

1. Ordinary and Life Members are **only** eligible to vote at the election.
2. A Member who has completed at least **two full years** as a member shall be entitled to contest for the post of Managing Council member or to propose or second a candidate for the election. Each such member can propose not more than **three** candidates. The candidate for the post of President should have completed ten years of post qualification experience relating to tax laws or any branch of accountancy or company secretarial practice.
3. Members whose membership subscription is in arrears shall not be entitled to contest any election or to propose or second any candidate for the election or to vote at the election.
4. Withdrawal of nomination for the elections can be made by the candidate on or before 6.00 p.m. on **Friday, May 25th, 2018.**
5. If elections are required to be held, the names of the valid candidates shall be intimated through the website of The Chamber as well as through a circular. The Members are requested to check through these mediums.
6. If elections are not required to be held, due to any reason whatsoever, the same shall be intimated through the website of The Chamber as well as through the Notice Board at the Chamber's office. The Members are requested to check through these mediums.
7. The voting, if required, will commence at 11.00 a.m. and shall end at 5.00 p.m.
8. The above is only a gist of the Election Rules. Please read Election Rules (Bye Laws) of The Chamber carefully on the website www.ctconline.org.

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CA Ketan Vajani & CA Nishtha Pandya

The Chamber News

Important events and happenings that took place between 7th March, 2018 and 7th April, 2018 are being reported as under:

I. ADMISSION OF NEW MEMBERS

- 1) The following new members were admitted in the Managing Council Meeting held on 16th March, 2018.

Life Membership

1	Mr. Shah Nirav Dhirajlal	CA	Mumbai
2	Mr. Doshi Dimple Bhikhalal	ITP	Mumbai
3	Mr. Shah Rushil Bankim	CA	Mumbai
4	Mr. Fadia Ronak Mukesh	CA	Mumbai
5	Miss Punjabi Ritu Jagdish	CA	Mumbai
6	Mr. Shah Aalok Naresh	CA	Mumbai
7	Mr. Shelke Ganesh Kanuji	ITP	Mumbai
8	Mr. Bairagra Ashishkumar Jaiprakash	CA	Mumbai
9	Miss Punjabi Pooja Jagdish	CA	Mumbai
10	Mr. Soni Deepak Gopal	CA	Mumbai
11	Mr. Budhkar Nikhil Nishikant	Advocate	Mumbai
12	Mr. Suthar Dhanraj Hiralal	CA	Mumbai
13	Mr. Shah Shreyam Bhupendra	CA	Mumbai
14	Mr. Choksi Mehulle V.	CA	Mumbai
15	Mr. Kanth Manish Kumar Binod	Advocate	Mumbai
16	Miss Furia Jainee Nitin	B. Com.	Mumbai

Ordinary Membership

1	Mrs. Dave Chhaya Shyamal	CA	Mumbai
2	Mr. Gada Piyush Manilal	CA	Mumbai
3	Mr. Bawa Kanwarjit Singh Gurdial Singh	CA	New Delhi
4	Mr. Tilak Abhishek Deepak	Advocate	Mumbai
5	Mr. Chakravarty Arijit Ashok	Advocate	Mumbai
6	Mr. Kothari Dipesh Balchand	ITP	Mumbai

7	Miss Makhecha Ushma Jatin	CA	Mumbai
8	Mr. Bhandari Pravin Bajirao	CA	Pune
9	Mrs. Shah Pradnya Sachin	CA	Pune
10	Mr. Chavan Romit Madhukar	CA	Mumbai
11	Mr. Golechha Gaurav Narendra	CA	Mumbai
12	Mr. Piyush Kamal Shriniwas	CA	Delhi
13	Mr. Shah Sanket Mukesh	CA	Mumbai

Student Membership

1	Mr. Pandya Soham Shailesh	CA	Mumbai
2	Miss Dhoot Aayushi Babulal	CA	Mumbai
3	Miss Jha Pratibha Harsh	CA – Final	Mumbai
4	Mr. Patel Varshil Manoj	CA	Mumbai
5	Miss Panchapakesan Lakshmy K.a.	CA – Final	Mumbai
6	Miss Kolte Chaitali Satish	CA	Mumbai
7	Miss Bahedia Dimple Hiralal	CA	Mumbai
8	Mr. Correia Sebastian	CA	Mumbai
9	Miss Yadav Vandana Ramachal	CA	Mumbai
10	Miss Patel Sheetal Anand	CA	Mumbai
11	Miss Gounder Pooja Dhamotharan	T.Y.B.Com.	Mumbai
12	Mr. Pereira Chrison Janet	CA	Mumbai
13	Mr. Nirbhavne Chirag Dayanand	T.Y.B.Com.	Mumbai
14	Mr. Sharma Anond Satish	CA	Mumbai
15	Miss Sherla Shruti Vithal	CA	Mumbai
16	Mr. Ghadigaokar Tejas Arun	CCA	Mumbai
17	Mr. Dharamshi Purav Yogesh	T.Y.B.Com.	Mumbai
18	Miss Nithya Kishorekumar	CA	Mumbai
19	Miss Nair Kavya Krishnadas	CA	Mumbai
20	Miss Varvdeyan Swati Vasantkumar	CA	Mumbai
21	Mr. Shah Parth Ashish	Student	Mumbai
22	Mr. Bhatia Paresh Himmatlal	CA	Mumbai
23	Mr. Derashri Umang Narendra	CA	Mumbai
24	Miss Darji Disha Devendrabhai	CA	Mumbai
25	Miss Hatkar Krina Ajay	CA	Mumbai
26	Mr. Modi Harshal Mahendra	CA	Mumbai
27	Miss Tendulkar Charuta Pradeep	CA	Mumbai
28	Mr. Kolambkar Vikrant Kanu	Student	Mumbai
29	Mr. Kale Abhijit Mohan	Student	Mumbai
30	Miss Virkar Sanjana Ranjit	CA	Mumbai
31	Miss Katarmal Deepali Khimji	Student	Mumbai
32	Mr. Kumar Raju Mritunjay	Student	Mumbai
33	Miss Joshi Bakshi Rashmikant	IPCC	Mumbai
34	Miss Phagnekar Pooja Sanjay	LLB	Mumbai
35	Miss Ganatra Pinky Neetu	Student	Mumbai
36	Mr. Pitale Ameya Abhay	LLB	Mumbai

37	Miss Chugle Harsha Shewakram	Student	Mumbai
38	Mr. Hule Sumit Babaji	BAF	Mumbai
39	Mr. Mehra Shivam Rajesh	LLB	Mumbai
40	Mr. Vaiti Larson Anthony	LLB	Mumbai
41	Miss Sewani Karishma Gopal	BMS	Mumbai
42	Mr. Bhatt Nilesh Bhaskar	CA	Mumbai
43	Mr. Chandan Raj Jatin	CA	Mumbai
44	Miss Bodetia Twinkle Omprakash	CA	Mumbai
45	Miss Lapasiya Bhakti Hirachand	CA	Mumbai
46	Miss Gandhi Divy Naresh	CA	Mumbai
47	Miss P. Y. Sushina	CA	Mumbai
48	Miss Verma Neelam Ramphal	CA	Mumbai
49	Miss Joshi Bhavita Kalpesh	CA	Mumbai
50	Miss Dand Tina Champaklal	CA	Mumbai
51	Miss Poojary Ashmika Chandrashekar	CA	Mumbai
52	Miss Shastri Swastika Devprasad	IPCC	Mumbai
53	Miss Gala Krina Anil	CA – Final	Mumbai
54	Miss Ramani Avani Ajay	CA	Mumbai
55	Miss Monani Richi Bhagwan	CA	Mumbai
56	Mr. Gupta Shravan A.	Student	Mumbai
57	Miss Patel Rashmi Yogesh	Student	Mumbai
58	Miss Patil Jyoti Shekhar	Student	Mumbai
59	Miss Raghvani Anisha Mayur	Student	Mumbai
60	Mr. Vora Merul Rajesh	CA	Mumbai

II. PAST PROGRAMMES

1. DIRECT TAXES COMMITTEE

Half Day Seminar on Charitable Trusts was held on 23rd March, 2018 at Babubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate. The seminar was addressed by CA Rajiv Luthia, CA Paras K. Savla & CA Gautam Nayak.

2. INDIRECT TAXES COMMITTEE

Workshop on GST Law jointly with AIFTP (WZ) , BCAS, GSTPAM, MCTC & WIRC of ICAI was held on 14th March, 2018 at GSTPAM, Mazgaon Library, 1st Floor, 104, Vikrikar Bhavan, Mazgaon, Mumbai – 400 010. The workshop was addressed by CA A. R. Krishnan, CA Sunil Gabhawalla, Ms. Nikita Badheka, Advocate and CA Parind Mehta.

3. INTERNATIONAL TAXATION COMMITTEE

Two days Intensive Study Course on Foreign Exchange Management Act (FEMA) jointly with Delhi Chapter was held on 23rd and 24th March, 2018 at India International Centre, New Delhi. The course was addressed by CA Vijay Gupta, CA Rajesh P. Shah, Mr. Divyanshu Pandey, Advocate, CA Hinesh Doshi, CA Amithraj AN, Mr. Lalit Kumar, Advocate, CA Dependra Kumar Agarwal, CA Pares P. Shah and CA Anup Shah. RBI Officials from Foreign Exchange Dept., New Delhi, Ms. Madhu Dwivedi, Assistant General Manager, Dr. M. K. Singh, Assistant General Manager and Mr. Prashanta K. Das, Assistant General Manager, also addressed the members.

4. MEMBERSHIP & PR COMMITTEE

- A) 2nd Triangular Box Cricket Tournament Jointly with the Malad Chamber of Tax Consultants and The Goods and Services Tax Practitioners' Association of Maharashtra was held on 10th March, 2018 at The Turf Club, Kandivali (East), Mumbai.

The final was won by The GSTPAM and the CTC was Runner up at the Tournament. The Man of The Match awards were given to Mr. Ankit Sanghvi, Mr. Nikhil Shah and Mr Mehul Sheth.

- B) Full Day Seminar on Important Tax Issues in Direct Taxes and GST was held on 17th March, 2018 jointly with the Aurangabad Branch of WIRC of ICAI and GSTPAM. The issues related to Direct Taxes was addressed by CA Paras K. Savla, CA Devendra Jain, and issues related to GST was addressed by CA Ankit Chande and CA Deepak Thakkar.

5. STUDENT COMMITTEE

- A) Student Orientation Course was organised for Articled Students from 8th to 10th March, 2018 at Maharashtra Seva Sangh Hall, Mulund. The course was addressed by CA Rakesh Vora, CA Kalpesh Katira, CA Hemang Shah , CA Jatin Lodaya, CA Mamta Shah and CA Nisha Gala.

- B) 45th Sir Jamshedji Kanga and Dr. Y. .P. Trivedi National Tax Moot Court Competition was held jointly with Government Law College, Mumbai in association with Sir Jamshedji Kanga Moot and Rotary Club of Bombay on 6th and 7th April, 2018. Twenty Law Schools/Colleges/Universities from various parts of country participated in the Competition.

III. FUTURE PROGRAMMES

1. DIRECT TAXES COMMITTEE

Workshop on Anti Abuse Provisions under the Income-tax Act and the interplay with Benami Transactions Act is scheduled to be held on 14th April, 2018 at M. C. Ghia Hall, Fort, Mumbai

2. IT CONNECT COMMITTEE

Workshop on Powerful Features in MS Excel / PowerPoint 2016 is scheduled to be held on 20th April, 2018 at Jai Hind College, A. V. Room, Churchgate, Mumbai.

3. INTERNATIONAL TAXATION COMMITTEE

- A) 12th Residential Conference on International Taxation, 2017 is scheduled to be held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore.

- B) 4th International Study Tour is scheduled to be held from 28th April, 2018 to 2nd May, 2018 at Hotel Le Meridien Mauritius.

(For details of the Future Programmes, kindly visit www.ctconline.org or refer The CTC News of April, 2018)



Indirect Taxes Committee

Workshop on GST Law organised jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC of ICAI for the year 2017-18 was held on 14th March, 2018 at GSTPAM, Mazgaon Library, Mumbai



Trustees replying to the queries at the Mega Brains' Trust Session

Study Circle & Study Group Committee



Study Circle Meeting on International Taxation held on 26th March, 2018 on the subject "Recent Amendments in the Budget for International Taxation and Recent Developments in PE"

CA Jimit Devani addressing the members. Also seen Ms Shraddha Kothari, faculty.

International Taxation Committee

Two days Intensive Study Course on Foreign Exchange Management Act (FEMA) held on Friday, 23rd March & Saturday, 24 March, 2018 jointly With CTC-Delhi Chapter



Group Photo with RBI Officials



Shri V.P. Verma, Past President, CTC and Advisor - CTC - Delhi Chapter, presenting memento to Mr. Ajay Singh, President, CTC

Faculties



CA Hinesh Doshi



CA Rajesh P. Shah



CA Paresh P. Shah



CA Anup P. Shah



CA Vijay Gupta



CA Amithraj A. N.



CA Deepender Agarwal



CA Divyanshu Pandey

Membership & Public Relations Committee

Full Day Seminar on Important Tax Issues held on 17th March, 2018 jointly with the Aurangabad Branch of WIRC of ICAI, GSTPAM and Tax Practitioners Association, Aurangabad



Dignitaries at Inaugural Session



Mr Ajay R. Singh, President delivering opening remark. Seen from L to R: S Shri CA Yogesh Agarwal, Secretary of WIRC Branch, Aurangabad CA Pranav Kapadia, President GSTPAM, CA Sachin Lathi, Chairman, WIRC Branch Chairman, Aurangabad, Mr. Sachin Gandhi, Co-Chairman, MPR Committee, (CTC) CA Aalok Singh, President, TPA, Aurangabad, CA Umesh Sharma, Member, CA Pankaj Parekh, Member

CA Devendra Jain, addressing the delegates

Indirect Taxes Committee

Study Circle Meeting held on 22nd March on the subject "Preparedness for GST Audit"

Webinar on E-Way Bill on GST held on 28th March, 2018



CA Deepak Thakkar, chairing the Session



CA Vasant Bhatt, Group Leader, addressing the members



CA Mitesh Katira addressing the members



CA Parag Mehta addressing the members

Study Circle & Study Group Committee

Study Group Meeting on Recent judgment on Direct Taxes held on 20th March, 2018



Shri Deepak Tralshawala, Advocate addressing the delegates

Membership & Public Relations Committee

2nd Triangular Box Cricket Tournament jointly with GSTPAM and MCTC
held on 10th March, 2018 at Turf Club, Kandivali, Mumbai



Team members - The Chamber of Tax Consultants



Shri Dinesh Tambde handing over the Man of the Match Trophy to Shri Mehul Sheth



Shri Jayprakash Tiwari handing over the Man of the Match Trophy to Shri Nikhil Shah



Shri Kishor Vanjara, Past President handing over the Man of the Match Trophy to Shri Ankit Sanghvi, CTC



Shri Kishor Vanjara, Past President and Shri Ajay R. Singh, President with Runner up Team, The Chamber of Tax Consultants

Direct Taxes Committee

Half Day Seminar on Charitable Trust held on 28th March, 2018 at IMC



CA Ketan Vajani, Hon. Jt. Secretary delivering opening remark. Seen from L to R: S/Shri CA Ashok Mehta, Chairman, Direct Taxes Committee, CA Rajiv Luthia, Faculty, Ms. Neelam Jadhav, Convenor, Direct Taxes Committee



CA Ashok Mehta, Chairman, Direct Taxes Committee welcoming the faculty and delegates. Seen from L to R: S/Shri CA Rajiv Luthia, faculty, CA Ketan Vajani, Hon. Jt. Secretary and Ms. Neelam Jadhav, Convenor, Direct Taxes Committee

Faculties



CA Rajiv Luthia

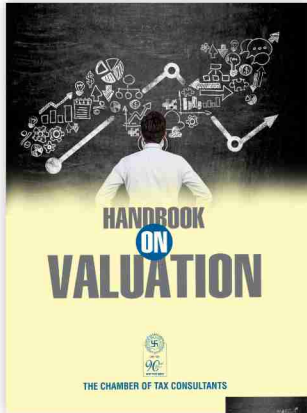


CA Paras K. Savla



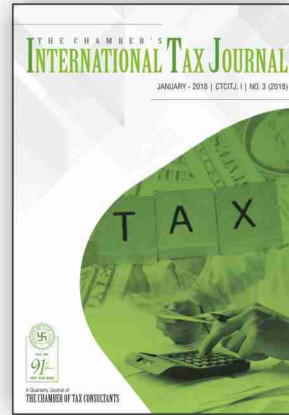
CA Gautam Nayak

CTC PUBLICATIONS



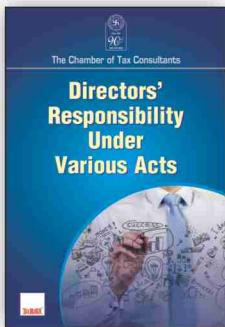
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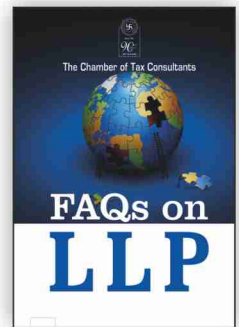
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Excel & Lead**